S. HRG. 98-245

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

H.R. 3036

AN ACT MAKING APPROPRIATIONS FOR THE TREASURY DEPARTMENT, THE UNITED STATES POSTAL SERVICE, THE EXECUTIVE OFFICE OF THE PRESIDENT, AND CERTAIN INDEPENDENT AGENCIES, FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1986, AND FOR OTHER PURPOSES

Administrative Conference of the United States
Advisory Commission on Intergovernmental Relations
Advisory Committee on Federal Pay
Committee for Purchase From the Blind and Other Severely Handicapped
Department of the Interior
Department of the Treasury
Executive Office of the President
Federal Election Commission
Federal Labor Relations Authority
General Services Administration
National Archives and Records Service
Nondepartmental witnesses
U.S. Merit Systems Protection Board
U.S. Postal Service
U.S. Tax Court

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TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

THURSDAY, MARCH 7, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 1:10 p.m., in room SD–116, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and Proxmire.

U.S. TAX COURT

STATEMENT OF HOWARD A. DAWSON, JR., CHIEF JUDGE

ACCOMPANIED BY:
SAMUEL B. STERRETT, JUDGE
PAUL NEJELSKI, COURT ADMINISTRATOR

OPENING STATEMENT

Senator ABDNOR. The subcommittee will come to order.

This afternoon's session is the first of the subcommittee's review of agency budgets for fiscal year 1986, and I want to offer a welcome to all of our witnesses.

We will be receiving testimony from the Honorable Howard A. Dawson, Jr., the Chief Judge of the U.S. Tax Court; Mr. Loren A. Smith, Chairman of the Administrative Conference of the United States; Mr. Martin L. Duggan, Chairman of the Advisory Committee on Federal Pay; Mr. Henry B. Frasier, III, Acting Chairman of the Federal Labor Relations Authority; Mr. John C. Miller, General Counsel of the Federal Labor Relations Authority, and Maj. Gen. Joseph H. Connolly, the Chairman of the Committee for Purchase from the Blind and Severely Handicapped.

As we begin, I want to note that the entire statement of each of our witnessess will be made a part of the record.

Judge Dawson, Chief Judge of the U.S. Tax Court, we will give you a very special welcome to our hearing today. Before you begin, however, I do want to note for the record that this will be your final appearance as Chief Judge, I am told.

Chief Judge DAWSON. Yes, sir; it will be.

Senator ABDNOR. And you are going to assume senior status this summer.

I just want to say to those here that under the judge's term as Chief Judge, the court has made significant strides in modernizing its operation. His leadership has been exemplary, and I want to thank you for a job well done, judge.

Chief Judge DAWSON. I certainly appreciate that a great deal, Mr. Chairman, and I would like to express my appreciation to you for your support and understanding and helpfulness during my tenure as Chief Judge, and I have gotten marvelous support, also, from your staff, from Chuck Parkinson and Dorothy Pastis.

Senator ABDNOR. You can praise me, but don't praise him too much. I will have to raise his salary, and we can't have that. We know they both do a great job, and it is a pleasure to work with you.

INTRODUCTION OF JUDGE STERRETT

Chief Judge DAWSON. I appreciate the opportunity to appear before the committee and present the Tax Court's request for fiscal year 1986. First, I would like to introduce to you Judge Samuel Sterrett, seated on my right, who will become the Chief Judge of the Tax Court this summer, at which time I will assume senior status.

Senator ABDNOR. We are glad you brought him along so he can see how tough we are.

Judge STERRETT. I know I have big shoes to fill.

Chief Judge DAWSON. Judge Sterrett has been on the court 16 years, and has been chairman of the court's personnel committee. We will put a copy of his biographical data in the record.

On my left I have Paul Nejelski, the court administrator. I don't think you have met him. He came to the court last May. He was the former circuit executive for the Third Judicial Circuit, and was the former director of the Institute of Judicial Administration at New York University. He has been a great help to the court.

Senator ABDNOR. We welcome both of you gentlemen.

PREPARED STATEMENT AND BIOGRAPHICAL SKETCHES

Chief Judge DAWSON. We have submitted our supporting statements and detailed information.

Senator ABDNOR. They will be made part of the record.

[The information follows:]

STATEMENT OF CHIEF JUDGE HOWARD A. DAWSON, JR.

Mr. Chairman, I appreciate the opportunity to appear before you and the other members of this committee and to present for your consideration the appropriation request of the United States Tax Court for fiscal year 1986.

INTRODUCTION OF CHIEF JUDGE ELECT

First, I would like to introduce Judge Samuel B. Sterrett who will assume the duties of Chief Judge of the Tax Court in June 1985. At that time I will assume senior status. Judge Sterrett has served on the Court for over 16 years. He has been an outstanding jurist; he has decided many important tax cases during his tenure; and he has been Chairman of the Court's Personnel Committee for several years. With your permission, I will submit for the record the biographical data with respect to Judge Sterrett.

Second, I would like to introduce our Court Administrator, Mr. Paul Nejelski, who came to the Court last May. Mr. Nejelski previously served as the Circuit Executive for the Third Judicial Circuit. I am also submitting his biographical data.

FISCAL YEAR 1986 BUDGET REQUEST

The budget request of the Tax Court for the fiscal year 1986 is $24,556,000 and 330 permanent positions. This amount represents an increase of $1,862,000 over the fiscal year 1985, including the $350,000 pay raise supplemental now pending before the Congress. Our request contains 10 new positions. This budget request reflects our best judgment as to the Court's needs for handling its pending and prospective case load. I will summarize the increase for you. Further justification for the specific items are contained in our budget submission.

NEW REQUIREMENTS

The Court is requesting $536,000 in new requirements. This amount includes the salaries and benefits for 10 new positions along with the necessary costs of travel, transportation, court reporting, communications and contract services. The number of employees of the Court would increase 3.1% over fiscal year 1985 while the case filings are projected to increase by 25%.

An additional $4,000 is required in the fiscal year 1986 to provide a master microfiche copy of all memorandum opinions to the Government Printing Office. Our agreement with the GPO is required by Federal statute so that all Federal depository libraries may receive copies of the Court's memorandum opinions.

The Court is also requesting $19,000 to provide training expenses for presidentially appointed judges. This will allow our judges an opportunity to meet with other Federal judges and learn new techniques for case management and court procedures.

PAY ADJUSTMENTS

During the fiscal year 1986, $231,000 will be needed to finance promotions and within-grade salary increases for employees who will be eligible for advancement.

OTHER COST ADJUSTMENTS

The Court will need $1,787,000 to cover other cost adjustments for the fiscal year 1986. The amount includes $1,139,000 for annualization to allow the Court to continue activities and staffing levels approved in prior years. Inflation will require an additional $301,000, and the GSA rent charges are being increased by $41,000.

The recent postage increase will require an additional $22,000 in the fiscal year 1986. Maintenance and leasing

costs for the Court's word processing equipment and mini-computer system will be $127,000 during the year.

The Court will also renew its reporting contract, which provides the trial transcripts, at an estimated increase of $157,000. The contract rates have not been increased in the last four years.

ONE-TIME ADJUSTMENTS

The Court is reducing its fiscal year 1986 request by a net amount of $692,000 for one-time adjustments. We are requesting the following new items during fiscal year 1986:

1. $100,000 to fund various management studies of the Court's operations.
2. $310,000 for new equipment to include expansion and modifications to the automatic files in the Public Files Section; additional word processors for the three new Special Trial Judges hired in the fiscal year 1985; replacement of the Court's high-speed copy machine; and to provide for upgrading the telephone system in the Courthouse located in Washington, D.C.

The following items were approved as one-time adjustments in our fiscal year 1985 request and the amount of $1,102,000 has been reduced from our fiscal year 1986 request:

1. $330,000 for purchase and installation of new carpet for the Tax Court building.
2. $89,000 for purchase of equipment, furniture and library books for the new Los Angeles office.
3. $568,000 for purchase of equipment, furniture and library books for the new Special Trial Judges space in the Judiciary Square Building in Washington, D.C.
4. $115,000 for word processing equipment.

THE COURT'S WORKLOAD

At the present time the United States Tax Court handles approximately 90% of all substantive tax litigation, exclusive of collection actions, in the Federal courts throughout the country. It is the only Court where a taxpayer can litigate his case without prior payment of the determined tax deficiency. Proceedings in the Tax Court are begun by filing a petition after the taxpayer has been sent a deficiency notice by the Commissioner of Internal Revenue. The deficiency notice procedure is one over which the Tax Court has no control. As the number of deficiency notices increase, the Court's docketed cases will also increase.

In the fiscal year 1970, 7,390 new cases were filed. In fiscal year 1975, the number of new cases filed was 11,213. In fiscal year 1984, 42,024 new cases were filed. Thus, over the past fourteen years the number of new cases has more than quadrupled, and in the last eight years it has tripled. For the fiscal year 1984, the increase in new cases filed was 23% more than in the fiscal year 1983.

The inventory of pending cases rose from 12,040 at the end of fiscal year 1970 to 16,448 at the end of 1975, which was a 37% increase. At the end of the fiscal year 1984, the inventory of pending cases stood at 63,598, a 428% increase, or more than four times the pending case load in 1970. The pending case load has been maintained since the fiscal year 1977 at approximately 150% of the number of cases filed each year.

For the fiscal year 1983, the gap between the number of petitions filed and number of cases closed was 5,276. For the fiscal year 1984, the gap was again narrowed to 4,926. For the first quarter of the fiscal year 1985, the Court closed about 400 more cases than the number of petitions filed. This decrease in the gap between filings and closings

was attributable primarily to the effective handling of small tax cases.

The pending case backlog consists mostly of recently filed cases. Most regular cases which are tried are disposed of within 12 to 18 months from the date of trial. This period does not include the time for filing briefs, which usually takes 4 to 6 months. By contrast, most of the small tax cases which are tried are disposed of within 6 months from the date of trial. This time lag should be substantially reduced in the near future because of the use of bench opinions in appropriate cases. Cases generally go to trial only when both parties indicate they are ready. In the meantime the judges are actively trying to prevail on the parties to settle before the scheduled trial date.

In the fiscal year 1977, the pending case load was 21,298 (85% regular cases, 15% small tax cases). By the end of the fiscal year 1984, the pending case load had increased 199% to 63,598 (33% shelter cases, 51% regular cases, 16% small tax cases). Small tax cases increased 222% during this time period, but most of this increase can be attributed to the increase to $5,000 per tax year in the statutory maximum for small tax cases. Pending regular cases increased by 79%.

The total pending case load has increased 199% since the fiscal year 1977 (42,300 cases), but shelter cases (21,034 cases) accounted for 50% of the increase. At the end of the fiscal year 1984, the Internal Revenue Service had over 330,000 tax shelter returns in their audit inventory. The number of cases that may be filed in the Tax Court is unknown at this time, but a large number can be expected in the next two or three years.

THE COURT'S PRODUCTIVITY

In a continuing effort to decrease the backlog of pending cases, the Court as a whole has increased its productivity.

The number of opinions written by the Court rose from 573 in 1970 to 796 in 1975 and to 2,274 in 1984. The number of cases closed by the Court increased from 6,610 in the fiscal year 1970 to 8,616 in the fiscal year 1975, and to 37,098 in the fiscal year 1984. To a large degree the increase in the number of cases closed reflects what appears to be a more flexible settlement policy of the Internal Revenue Service.

Of the 796 opinions written in the fiscal year 1975, 271 were written in the small tax cases and 525 in regular cases. Of the 2,274 opinions written in the fiscal year 1984, 1,360 were written in regular cases and 914 in the small tax cases.

SMALL TAX CASE PROCEDURES

Under the small tax case procedures, which are optional with the taxpayer, trials are conducted in an informal and prompt manner. The rules of evidence are relaxed; neither party is required to file a brief; and neither party may appeal. The jurisdictional limit for the small tax case was recently increased by Congress from $5,000 to $10,000 in the deficiency amount for each taxable year.

The Court currently has thirteen special trial judges assigned to handle the small tax cases. They are also assigned regular cases where the amount of the deficiency is less than $10,000 and certain complex regular cases which are reviewed and adopted or modified by a presidentially appointed judge of the Court.

The number of cases in which the small tax case election has been made has increased steadily since the provisions became law. In the fiscal year 1971, 1,349 small tax cases were filed; in the fiscal year 1985, 3,290 small tax cases were filed; and in the fiscal year 1984, 11,680 small tax cases were filed.

The small tax case procedures, as conceived by Congress, contemplated that the cases would be heard and disposed of

promptly. Expeditious handling of these small tax cases helps maintain confidence in the efficiency and fairness of the revenue and judicial systems.

ACTIONS TO REDUCE BACKLOG

The budget justification for the fiscal year 1986 lists what Congress and the Court have done to alleviate the pending case load. For the fiscal year 1986 the Court also proposes to (1) continue to improve the management, handling, and disposition of tax shelter cases; (2) implement the computerization of the Clerk's operations; (3) improve our practice and procedures so that the Court can provide better service and justice to all litigants; (4) provide training for the presidentially appointed judges; and (5) institute a series of management studies throughout the Court to improve its overall operations.

CONCLUSION

During the fiscal year 1984, the amount of deficiencies ultimately determined by the Court to be owing by petitioners was $660,201,740, or about 26 times the amount of our fiscal year 1986 budget request. The 63,598 cases pending in the Tax Court at the end of the fiscal year 1984 involved deficiencies determined by the Internal Revenue Service in the total amount of $12,129,097,160. To the extent of taxes owed, the revenue ultimately involved in these cases cannot be collected until they have been heard and decided or otherwise disposed of. Delays in closing these cases deprive the Treasury Department of revenues which are due. To the extent that the determined tax liabilities are not in fact owed, they create financial uncertainties for corporations, businessmen, and individuals in making business, investment, and other decisions.

The number of cases filed from 1977 to 1986 has increased over 400% and the number of cases closed has increased over 450% during the same time period. Thus, the productivity of the existing personnel has increased considerably over the past few years.

The Tax Court will continue its determined effort to narrow the gap between the cases closed and the cases filed. To do this, the Court must have adequate funds, resources, and automation to cope with the pending case load and meet future challenges. The Commissioner has notified the Court that the Internal Revenue Service has thousands of proposed deficiencies in the audit process concerning tax shelters and tax protesters. Unlike many Government agencies with multiple programs, the Tax Court has only one program--the judicial resolution of Federal tax cases. Whenever funds are decreased, the only area in which the Court has any flexibility is to reduce the amount of travel it does to hear cases. If the Tax Court does not travel and hold trial sessions, the case load will continue to increase and the amounts ultimately due will not become available to the Treasury Department.

Mr. Chairman, that concludes my statement. I will be pleased to answer any questions the Committee may have.

BIOGRAPHY OF PAUL NEJELSKI

Paul Nejelski, 46, has had broad experience in court administration, having most recently served as Circuit Executive for the Third Circuit in Philadelphia, Pennsylvania. He has also been the deputy administrator for the Connecticut Judicial Department, Deputy Assistant Attorney General in the U. S. Justice Department's Office for Improvements in the Administration of Justice, and the staff director of the American Bar Association's Action Commission to Reduce Court Costs and Delay.

A graduate of Yale College (magna cum laude) and Yale Law School, Nejelski also holds a Masters in Public Administration degree from American University specializing in computer technology. He has served as director of the Institute of Judicial Administration at New York University, as Assistant Director of the Harvard Law School's Center for Criminal Justice, and the first chief of court research at the National Institute of Justice.

A member of the New Jersey bar, Nejelski was an Assistant U. S. Attorney in Newark and later in Washington headed a unit responsible for all civil and criminal litigation involving immigration and citizenship for the Justice Department. Author of numerous articles, he has served as a consultant to a variety of organization, including the General Accounting Office, the National Academy of Science, and the Canadian Institute for the Administration of Justice.

He has been the Court Administrator for the U. S. Tax Court since April of 1984.

He resides in Bethesda, Maryland with wife Marilyn, daughter Nicole (16), and son Stephen (14).

Biography of Samuel B. Sterrett

Judge Samuel B. Sterrett has been elected as Chief Judge of the United States Tax Court to serve a 2-year term beginning July 1, 1985. He will succeed Howard A. Dawson, Jr., who is the present Chief Judge. The election of the Chief Judge by the judges of the Tax Court is undertaken biennially in accordance with statutory requirements.

Judge Sterrett was born in Washington, D. C. on December 17, 1922. He graduated from St. Albans School in 1941, from Amherst College in 1947, and from the University of Virginia School of Law in 1950. He served during World War II with the United States Army and sailed in the Atlantic and Pacific as a second mate in the merchant marine after graduating from the United States Merchant Marine Academy in 1945. In 1959 he received an LL.M. in Taxation from New York University School of Law.

He practiced law with the firm of Alvord & Alvord in Washington, with the Office of Chief Counsel, Internal Revenue Service, in New York City, and was a partner in the law firm of Sullivan, Shea & Kenney, Washington, D. C., at the time of his appointment by President Johnson to the Tax Court in August 1968. He was reappointed to the Court by President Nixon in May 1970.

Judge Sterrett was a member of the Board of Managers of Chevy Chase Village from 1970 to 1974 and served as its Chairman from 1972 to 1974. He was a member of the Chapter of the National Cathedral from 1973 to 1981 and of the Governing Board of St. Albans School from 1977 to 1981. He was a member of the Board of Trustees of the Washington Hospital Center from 1967 to 1984 and served as its Chairman from 1979 to 1984. He has been Chairman of the Board of Trustees of the Washington Healthcare Corporation, a holding company, since its inception in 1982. He is a trustee of the Louise Home.

Judge Sterrett is a member of the Virginia State Bar, and of the Federal, District of Columbia, and America Bar Associations (section of Taxation of latter two).

He married Jeane McBride in 1949; they have two sons and a daughter.

BUDGET REQUEST

Chief Judge DAWSON. I will summarize the requests and indicate to you some of the initiatives the court has taken during the past year, and tell you as briefly as I can what I think the future holds in store for the Tax Court and where we are headed, and the amount of litigation that confronts us today.

Our budget request for fiscal year 1986 is $24,556,000 and 330 permanent positions. This amount includes the $350,000 pay raise supplemental now pending before the Congress. So the net increase is $1,862,000.

The request includes 10 new positions. However, five of those positions are necessary because one of our judges will assume senior status during the year 1986, and of course the new judge coming in will have two law clerks and two secretaries to round out his staff.

The other five positions are clerical, mainly positions in the docket, petitions, and calendar sections of the clerk's office.

The increase requested includes the following specific items: First, $536,000 for salaries and benefit costs for the additional personnel I just mentioned; $4,000 would be used to provide the Government Printing Office with a master microfiche copy of all the court's memorandum opinions, which by law is now required to be furnished to all Federal depository libraries.

We didn't know that our opinions were that popular.

Third, we have an item of $19,000 which would provide training expenses for Presidentially appointed judges. We have in the past year begged some of our training off the Federal Judicial Center, and they have been gracious to us in providing that, but this will permit us to reimburse them for that and pay for the other expenses that are necessary to training.

There is an item of $231,000 which is needed to finance promotions and within-grade increases for our employees, particularly those that would be eligible for advancement. Most of those are law clerk positions.

The sum of $1,139,000 is needed to allow the court to continue activities and staffing at levels which have been approved for prior years. Forty-one thousand dollars is needed for increased GSA rent charges; $22,000 for additional postage charges; and $127,000 for maintenance and leasing costs for the court's new word processing and minicomputer system which the committee authorized us in a supplemental appropriation to purchase last year; and $157,000 will be needed for increased reporting costs and trial transcripts, because this year we will have to renegotiate our reporting contract, which goes out on open bid.

There are some one-time adjustments we are requesting, $310,000 for new equipment to expand and modify the automatic filing system in our public files room, three additional word processors, replacement of the court's high-speed copy machine, and upgrading the telephone system of the court. We are also requesting $100,000 to fund management studies regarding the court's operations.

Now, that sums up our requests. What I would like to do now is to point out to you some of the initiatives that the court has taken.

INCREASE IN CASELOAD

As you probably know, Mr. Chairman, over the past 6 years the court has been confronted with a substantial and dramatic increase in its caseload. We have seen the number of cases filed in 1 year increase from 17,000 in 1979 to 42,000 in 1984. During that same period, we have doubled our efforts and we have increased the number of cases closed from 13,000 in 1979 to over 37,000 in 1984.

Since I became Chief Judge on July 1, 1983, the court has closed 58,000 cases, a record high for any comparable period during its 60 years of existence. We are proud of that record.

But with the higher productivity, there is still a gap, somewhat smaller, for cases filed and cases closed.

Last year, the court also reached a record high in the number of opinions that it has written, 2,274 opinions. As you know, Mr. Chairman, in the Federal tax litigation arena, the Tax Court really stands as the buffer, or the safety net, between the American taxpayer on the one hand and the Internal Revenue Service on the other. Our prime objective always is to try to resolve our disputes fairly, competently, and promptly. In carrying out that objective, the court has taken certain positive actions this past year to improve as best we can the quality and the quantity of its work, and I would like to emphasize some of those now.

I will point out, however, for the record, that I wrote to you, Mr. Chairman, on February 4 and I detailed in that letter approximately 15 initiatives which the court has taken in the past year.

Senator ABDNOR. If I could interrupt, we will make that letter a part of the record, also.

Chief Judge DAWSON. Very well. I would be delighted to have you do that.

[The letter follows:]

LETTER FROM HOWARD A. DAWSON, JR.

February 4, 1985

The Honorable James Abdnor
Chairman, Appropriations Subcommittee
on Treasury, Postal Service &
General Government
United States Senate
309 Hart Office Building
Washington, D.C. 20510

Dear Senator Abdnor:

Pursuant to the provisions of Title 31, United States Code, Section 720(b), I am submitting this statement on actions which have been or will be taken on the recommendations contained in the General Accounting Office report (GAO/GGD 84-25) dated May 14, 1984, entitled "Tax Court Can Reduce Growing Case Backlog and Expenses Through Administrative Improvements."

At the outset I think it is important to point out that the GAO review of the Tax Court's operations covered, for the most part, only the fiscal year 1981. Since that year significant changes and improvements have been made in the Court's procedures, resulting in the increased disposition of cases and productivity. Special emphasis has been placed on active case management by our judges and special trial judges. It should be noted that in the fiscal year ended September 30, 1983, the Court closed 28,945 cases compared to 18,906 cases closed in the fiscal year ended September 30, 1981. And from October 1, 1983 through September 30, 1984, we closed a record high of 37,098 cases.

Since I became Chief Judge on July 1, 1983, the following actions and procedures have been taken to improve our handling of the constantly increasing caseload of the Tax Court:

1. During the summer of 1983 the Court held additional trial sessions in California to facilitate the disposition of small tax cases and special cases involving "tax protesters." California was selected because of the heavy case inventory there. Similar small tax case trial sessions were held during the summer of 1984 in California and other locations. Special sessions were also held in tax shelter cases in several cities, particularly Los Angeles, San Francisco, New York, Chicago, and Dallas. Four consecutive weeks of "tax shelter" cases were set for Los Angeles during August and September, and a judge and a special trial judge were assigned to hear those cases.

2. Additional courtrooms have been acquired in Los Angeles and San Francisco so that the Court can better serve the litigants in those locations by having more frequent small, regular and special sessions. Approximately 30 percent of the Court's total caseload is presently concentrated in the State of California. Consequently, during the fall term of 1984 we held additional trial sessions in the California cities, and one judge was assigned to all Los Angeles regular trial sessions for that period.

3. On July 1, 1983, the Court issued General Order No. 8 and Delegation Order No. 8 authorizing the assignment of additional cases and motions to special trial judges pursuant to the provisions of sections 7456(d) and 7459(b), Internal Revenue Code. These orders have created a better distribution of the workload between judges and special trial judges by putting more cases involving deficiencies of less than $5,000 under the control of the special trial judges. On January 16, 1984, these procedures were incorporated into Rules 182 and 183, Tax Court Rules of Practice and Procedure.

4. Since October 1983, special trial judges have been assigned almost all motions for judgments on the pleadings and summary judgments, as well as motions to dismiss for failure to state claims upon which relief can be granted. These are now being considered on the papers submitted and without hearings unless the Court believes a hearing is justified. Most of these cases involve "tax protesters" who, for the most part, raise frivolous and groundless claims that result in the imposition of damages up to $5,000 under Code section 6673. About 520 such cases were disposed of under these summary procedures in the 1984 fiscal year.

5. On January 16, 1984, the Court issued a revised edition of its Rules of Practice and Procedure. Some rules were clarified and updated. On October 15, 1984, the Rules Committee completed new rules for partnership actions in order to implement the provisions of TEFRA.

6. The Court has substantially increased the number of trial sessions assigned to judges and special trial judges. For example, we scheduled a record number of 94 trial weeks for regular judges during the 1984 fall term. In addition, the number of cases and estimated trial hours have been substantially increased with respect to all trial sessions.

7. The judges and special trial judges are increasing their use of bench opinions. In the 1984 fiscal year, bench opinions were rendered in 131 regular cases and 207 small tax cases. We expect that there will continue to be an increase in bench opinions in the future as our judges become more accustomed to disposing of cases in that manner. This should also reduce substantially the average time for the issuance of opinions.

8. The Court has been successful in identifying more groups of tax shelter cases and more and earlier assignments have been made to the judges and special trial judges. Many large groups involving hundreds of cases have been assigned to judges. This should assist in the judicial management and ultimate disposition of such cases. During the past fiscal year the Court has decided a large number of tax shelter cases, and it is hoped that the precedent opinions in the "test" cases will eventually result in the settlement of many others.

During the spring of 1984 Judge Simpson was assigned all tax shelter cases where the place of trial is Chicago. There were about 2,500 of these cases. Judge Simpson issued pretrial orders, conducted pretrial hearings and conferences to facilitate the disposition of these cases by settlement or trial. About 1,200 of these cases have already been settled. Test cases in various tax shelter groups were tried for three weeks in May; four weeks in June and July; and four weeks in September and October. We are hopeful that the "Chicago experiment" will be productive and helpful to the Court in

future planning. Recently large groups of cases have been identified where Newark, New York, and Los Angeles are the places of trial. These groups have already been assigned to judges.

Certainly the most critical and chronic problem confronting the Tax Court is how to handle the mass of tax shelter cases which have been filed in the past few years. Presently there are about 22,000 tax shelter cases. It is clear that petitioners are not anxious to have their tax shelter cases come to trial and usually they report them as "not ready" when trial status requests are issued by the Court. The respondent (Commissioner of Internal Revenue) is the one who is primarily interested in resolving such cases. Thus, there appears to be a massive "warehousing" of these cases in the Tax Court by petitioners and their counsel. Identification and coordination problems frequently arise. While we are now getting a firm handle on the problems connected with these cases, we have found it difficult. The Tax Court has no control over the filing of petitions. If the Commissioner issues more notices of deficiencies, a substantial number inevitably result in petitions being filed with this Court.

9. The Court recommended and supported the enactment of section 475(a) of H.R. 4170 (Tax Reform Act of 1984) increasing the jurisdictional limit in small tax cases from $5,000 to $10,000 for any one taxable year. We think the special trial judges will be able to handle almost all of the small and regular cases under $10,000, which now represent about 40 percent of the Court's caseload.

10. In July 1983 the Court contracted with American Management Systems to conduct a feasibility study for the computerization of certain functions of the Clerk's operations, particularly the development of a case tracking system and a calendaring system. The AMS final report was submitted to the Court in January 1984. A request for supplemental appropriations for the fiscal year 1984 was submitted to Congress in March to cover the initial costs for computerization. When appropriated funds became available in August, the computer project was begun. The GAO report recommended the use of computers and word processors. AMS conducted a study on the Court's use of word processors, and word processors have been purchased and are in operation in all offices. The Court is now taking advantage of such automated equipment. We think it is needed to assist in the processing of court documents and in developing needed management information. The full implementation of the computer project will take another year.

11. In May 1984 the Court employed a skilled administrator, Paul Nejelski, who previously served as the Circuit Executive for the United States Court of Appeals for the Third Circuit and as the Director of the Institute for Judicial Administration at New York University.

12. The Court's Committee on Admissions and Discipline initiated proceedings against lawyers admitted to practice before the Court who engage in filing frivolous petitions and fail to comply with our orders.

13. On October 1, 1984, the Court began a new system for the identification of windfall profit tax cases. About 100 of these were filed during the summer months. All of these cases are being assigned to one judge for coordination and control.

14. In November 1984, the Court held its first major Judicial Conference in Williamsburg. It was attended by our judges and special trial judges; representatives of the Section of Taxation of the American Bar Association; representatives of the Chief Counsel's Office, Internal Revenue Service; eighteen outstanding tax litigation lawyers from all sections of the nation; and representatives of the tax writing committees of the Congress. It was a very successful and productive conference and, as a result of the matters discussed, the Court should be able to improve its case management and procedures. Some of the suggestions and recommendations are already being implemented.

15. On January 2, 1985, the Court began a limited experiment in decentralization at its facility in the Westwood area of Los Angeles, California. At first small tax cases will be heard there. At a later date regular cases, where the amount in dispute is less than $10,000 for any one taxable year, will also be heard there, as well as interlocutory motions.

The dramatic rise in the Court's caseload during the past ten years (new cases filed have increased from 8,757 in 1974 to 42,024 in 1984) has been attributable to several factors. First, the substantial increase in the audit activities of the Internal Revenue Service has resulted in more taxpayers contesting IRS determinations. Second, there has been a proliferation of new and frequent Federal tax statutes in recent years which has added to the complexities of the Internal Revenue Code. Third, the tax litigation system is being clogged because so many taxpayers perceive the current tax laws as being unfair, complicated and ineffective. In testimony on March 4, 1984, before the House Appropriations Subcommittee for the Treasury, Postal Service and General Government I made the following statements:

> Another factor that has contributed to the dramatic increase in our caseload is the growing dissatisfaction of the people with the Federal income tax laws. They see that taxes are high; that cheaters are often getting away without detection or payment; that the statutory provisions and rules seem incomprehensible; and that loopholes allow the wealthy to weasel out of paying their fair share while middle-income and poor families get nailed. And the complexity and crazy-quilt pattern of our income tax laws are driving taxpayers to exasperation and making them not only contentious but at times rebellious. A hodgepodge of special breaks is fanning the fire among many Americans that our entire tax system is unfair. There are over 100 major loopholes. There are vertical and horizontal inequities that pervade the system. It is inefficient. Certainly the best tax law is one that everybody understands. Very few people fully understand our Federal tax laws. I, for one, think the people are crying out for major reform--a tax law that is simple, understandable, and predicable, and one that they can comply with it. If this could be accomplished, it would, in my judgment, cure the mass of tax litigation which is clogging the United States Tax Court today.
>
> The best way to make the tax system fairer, simpler and less distorting in its impact on invest-

ment is to reduce sharply both the incentive and the opportunity for tax avoidance. Congress already has before it a tax reform measure--the Bradley-Gephardt bill--that would close many loopholes and sharply reduce tax rates. There would be just three rates for individuals. It would create a modified "flat rate" income tax which would recover billions lost through tax evasion and tax avoidance. There would be some deductions and exclusions, but very few.

A second alternative is being considered by the Treasury Department staff--a consumption tax. That would probably encourage savings and discourage buying and would have the effect of reducing interest rates and lowering the deficit.

Notwithstanding the case management initiatives taken by the Tax Court and the improvement in its productivity, the small number (36) of judges and special trial judges will find it extremely difficult to handle its caseload if the flow of new cases continues to increase substantially in the future. There is an optimum to productivity and we are rapidly approaching it. Basically there are three courses of action for reducing the Court's caseload: (1) add more judges; (2) improve management and procedures, and thus increase productivity; and (3) stem the flow of cases by restricting access to the Court. The first two courses of action have been taken. The third needs to be given serious consideration.

In my judgment the Tax Court is taking positive actions to improve the quality and quantity of its work. We appreciate the recommendations made by the General Accounting Office, and we are implementing them to the extent we think they are workable. The actions taken on the specific recommendations contained in the GAO report are enclosed in the Appendix attached hereto.

Sincerely yours,

Howard A. Dawson, Jr.

Howard A. Dawson, Jr.
Chief Judge

TAX SHELTER CASES

Chief Judge DAWSON. Let me highlight some of those that I think are particularly significant.

First, we are continuing to improve the handling, management, and disposition of tax shelter cases. About 130 groups, sometimes large groups, groups of several hundred—in fact, one group has as many as 1,004 cases in it—have been assigned and heard by our judges and special trial judges. The precedent opinions, we have issued 35 or 40 opinions in the past year that involve various types of tax shelters, are helping us to dispose of other similar cases.

Our message for those petitioners who are involved in abusive tax shelters, and I am sure you have heard a lot about those before——

Senator ABDNOR. Yes.

Chief Judge DAWSON. That they would be well advised to settle their cases by accepting the out-of-pocket costs offered by the Internal Revenue Service, and the reason is that the Government has prevailed in almost all abusive tax shelter cases.

COURT AUTOMATION

Second, we have begun the computerization of the clerk's operation, primarily a case tracking, docketing, and calender system.

We have a minicomputer that has been purchased, and we are working with the vendor on the adaptation of the software system. We think this will be fully implemented in a year's time.

DECENTRALIZATION

As I promised you last year, the court began on January 2, 1985, an experiment in decentralization of its facility in the Westwood area of Los Angeles, CA. A special trial judge is now stationed there full-time and a second judge will be temporarily assigned there in April. They are hearing all the small tax cases in the Los Angeles area.

At a later date, we plan to phase in the regular cases which are under $10,000 in amount, and later that will be expanded to include interlocutory motions. We are very optimistic that this experiment will succeed.

BENCH OPINIONS

Our judges have increased the use of bench opinions in the last year to speed the disposition of cases. In 1984, bench opinions were rendered in 131 regular cases and 207 small tax cases.

TRIAL SESSIONS

The court has substantially increased the number of trial sessions. We have added more hours to the trial session in an effort to move the cases.

On January 28 of this year, I issued a press release announcing that in the fall term of 1985 the court would adopt some different procedures for scheduling trial sessions and giving notices of trial. Forty per-

cent of the court's entire docket is centered in three major cities, Los Angeles, San Francisco, and New York, and 60 percent of it in nine major cities. The other cities are Newark, Washington, Chicago, Miami, Philadelphia, and Dallas.

The court is going to focus its effort to dispose of more cases in those cities during the fall term, and we are going to dispense with our customary trial status request in those areas in an effort to move the cases.

We also plan to have our judges work—two or three of them—probably as a team in handling sessions in those cities. This is simply a variation of the back-to-back trial sessions assigned to a single judge which have worked well in the past.

INCREASE IN FILING FEES

I would like to point out to the committee that effective May 1, the filing fee for all cases will be fixed at $60. We believe this is justified for even a small tax case, which previously was $10, mainly because Congress has increased the jurisdictional amounts steadily over the years from $1,000 up to the present $10,000. However, as a safeguard for the small taxpayer who is unable to pay that $60 fee, waivers will be granted under appropriate circumstances.

WINDFALL PROFITS

We have also set up a new system for the identification of windfall profits tax cases. About 100 of these cases have been filed recently. All of them have been assigned to one judge for coordination and control.

JUDICIAL CONFERENCE

In November 1984, the court held its first major judicial conference at Williamsburg. In attendance were the judges and special trial judges of the court, representatives of the section on taxation of the American Bar Association, and representatives of the chief counsel's office of the Internal Revenue Service. We selected 18 outstanding tax litigation lawyers from all sections of the country, and we had representatives from the taxwriting committees of the Congress there.

I think it was a very successful and productive conference. As a result of what we discussed there, the court should be able to improve its case management procedures further. Some of these recommendations are already in the course of being implemented.

INCREASE IN CASELOAD

Mr. Chairman, I realize that the logical question to ask is, "Why has there been such a dramatic rise in the court's caseload in the past 6 years?" I think it is attributable to three factors.

First, substantial increase in the audit activities of the Internal Revenue Service has resulted in more taxpayers contesting the Internal Revenue Service determinations, and as more tax notice deficiencies are issued, then the court receives more petitions, because this is the only

nonprepayment forum in the country. It is inevitable and there is really nothing the court can do to stem the flow.

Second, there has been a constant proliferation of new and frequent Federal tax statutes in the recent years which have added greatly to the complexity of the Internal Revenue Code. Every day, I shudder when I look at a Federal Tax Code that aggregates about 3,000 pages of highly complex and technical provisions.

Third, the tax litigation system is being clogged because many taxpayers perceive the current tax laws as being unfair, complicated, and ineffective.

One year ago, in reply to a question submitted by Congressman Conte before the House Appropriations Committee, I submitted a statement as to the reasons why I thought the tax laws were too complicated. I will be glad to read that if you want me to.

Senator ABDNOR. We will make it a part of the record.

[The letter follows:]

INCREASE IN CASELOAD

Mr. CONTE. To what do you attribute the dramatic increase in caseload over the years, particularly from 1975 to 1983?

Judge DAWSON. It is attributable primarily to the rapid and enormous increase in tax shelter and tax protester cases. About one-third of the court's present pending cases are tax shelters, and there are between 6,000 and 7,000 tax protester cases. The remainder of the increase in the caseload inventory is not very abnormal.

Another factor that has contributed to the dramatic increase in our caseload is the growing dissatisfaction of the people with the Federal income tax laws. They see that taxes are high; that cheaters are often getting away without detection or payment; that the statutory provisions and rules seem incomprehensible; and that loopholes allow the wealthy to weasel out of paying their fair share while middle-income and poor families get nailed. And the complexity and crazy-guilt pattern of our income tax laws are driving taxpayers to exasperation and making them not only contentious but at times rebellious. A hodgepodge of special breaks is fanning the fire among many Americans that our entire tax system is unfair. There are over 100 major loopholes. There are vertical and horizontal inequities that pervade the system. It is inefficient. Certainly the best tax law is one that everybody understands. Very few people fully understand our Federal tax laws. I, for one, think the people are crying out for major reform—a tax law that is simple, understandable, and predictable and one that they can comply with it. If this could be accomplished, it would, in my judgment, cure the mass of tax litigation which is clogging the U.S. Tax Court today.

The best way to make the tax system fairer, simpler, and less distorting in its impact on investment is to reduce sharply both the incentive and the opportunity for tax avoidance. Congress already has before it a tax reform measure—the Bradley-Gephardt bill—that would close many loopholes and sharply reduce tax rates. There would be just three rates for individuals. It would create a modified flat rate income tax which would recover billions lost through tax evasion and tax avoidance. There would be some deductions and exclusions, but very few.

A second alternative is being considered by the Treasury Department staff—a consumption tax. That would probably encourage savings and discourage buying and would have the effect of reducing interest rates and lowering the deficit.

TAX LAW REFORM

Chief Judge DAWSON. I would like to add to those statements that I made 1 year ago and say that I think the national exasperation with the present labyrinthine tax laws is what is generating momentum now for broad structural simplification and reform.

Today, the average American taxpayer literally needs a modern-day Rosetta stone to find his way through the thicket of all these complex, and sometimes indecipherable, tax laws. The President has urged tax simplification and reform. So have the respective chairmen of the tax-writing committees of the Senate and the House. Congress has before it the Bradley-Gephardt bill, the Kemp-Kasten bill, and others, and the Treasury is prepared to submit its proposals, I think, by May 1.

There is no doubt in my mind that all citizens, as well as the U.S. Tax Court, would be best served by tax simplification and reform.

Senator ABDNOR. You are endorsing it?

Chief Judge DAWSON. Yes; I am. I think it is a stark necessity if we are to preserve the great American tradition of voluntary compliance with our tax laws. Also, I think there is a real need to shift the burden of taxes from lower- and middle-income people to those who are better able to pay.

At the same time, probably corporate taxes should be increased so that the business giants of the Nation pay their fair share. I know certainly that the average taxpayer who pays several thousand dollars of Federal income taxes each year has little faith and respect for a system where General Electric, Dow Chemical or W.R. Grace & Co., didn't pay a dime of taxes last year. I don't think we can afford too much more corporate welfare in these times of high deficits.

The Tax Court is making, I think, a valiant effort to cope with the avalanche of cases which is not of its own making. I think all of us, judges and employees alike, are trying to work hard and do a good and conscientious job. If we are to continue to fulfill this mission of providing adequate and prompt judicial services in Federal tax cases, I think we will need the resources we are seeking.

I sincerely hope the committee will see fit to approve this request. I will be very pleased to answer any questions that you or other members of the committee may have.

AUTHORIZED NUMBER OF JUDGES

Senator ABDNOR. Thank you, Judge Dawson. It is a thorough and self-explanatory statement. We don't have that many questions.

You have all the authorized judges and special trial judges on board now?

Chief Judge DAWSON. We have all the Presidentally appointed judges, 19 which are authorized, on board. We have 13 special trial judges. One retired on disability at the end of the year, and we are in the process of replacing him, and employing three additional special judges at the present time. Commitments are out, and they will be aboard inside of 2 or 3 months.

INCREASE IN CASELOAD

Senator ABDNOR. This year you have been able to see improvements, have you, in speeding up your caseloads?

Chief Judge DAWSON. Yes, sir.

Senator ABDNOR. There is quite a difference.

Chief Judge DAWSON. We increased the number of closings last year by 8,000 cases over the previous year.

Senator ABDNOR. This would be good for a while, but the caseloads keep climbing. Is there anything you can do to slow it down?

Chief Judge DAWSON. Well, as I mentioned previously, something should be done to stem the flow. I think if we get some tax simplification and reform that the Tax Court case load will go down.

Senator ABDNOR. Are these frivolous, or are they pretty important? Are there a lot of smaller, frivolous cases?

Chief Judge DAWSON. No; out of the 63,000 cases which are pending in the Tax Court today, about 12,000 to 13,000 are small tax cases, 22,000 are the tax shelter cases, and the rest are regular cases.

Approximately 40 to 42 percent of the Tax Court's workload are cases where the amount of the deficiency is less than $10,000.

The main problem is in two areas, Senator, the tax shelters and the tax protesters, where we probably have 7,000 or 8,000 cases.

Senator ABDNOR. Gentlemen, while you were giving your statement Senator Proxmire, a very important gentleman on this committee—I don't know why he stays down there.

SENATOR PROXMIRE'S STATEMENT

Senator PROXMIRE. I thought maybe Dennis would show up.

Thank you very much, Mr. Chairman.

Mr. Chairman, I appreciate your letting me make a statement. I have to leave shortly because, as you know, there is another subcommittee meeting in a few minutes and I have to go to that.

I am pleased to see that most of the budgets of the agencies scheduled for this afternoon are either below or slightly above their fiscal year 1985 levels. For example, the Federal Labor Relations Authority is requesting an increase of 1.7 percent over its 1985 budget. The Administrative Conference of the United States is being cut below current levels by a small amount. The Advisory Committee on Federal Pay is slightly below last year's level, and the Committee for Purchase from the Blind and other Severely Handicapped is asking for only a 2.3-percent increase.

So the only agency appearing today is the U.S. Tax Court, which is asking for a larger increase.

Chief Judge DAWSON. It is 8.2 percent.

Senator PROXMIRE. That is not quite the way I figure it.

Chief Judge DAWSON. Am I figuring it wrong?

Senator PROXMIRE. You are in the business of taxes, and you may be right, but I have computed a 9.7-percent increase over your appropriation. There was a supplemental, and if you add the supplemental into 1985, then, of course, you do have a smaller increase. But, who knows, I think there might be a supplemental in 1986, too.

I like to compare apples and apples, and I am comparing what you got this year and last year, including the supplemental of last year.

Chief Judge DAWSON. That is about $22,600,000, counting the supplemental.

Senator PROXMIRE. So if you take the supplemental out, it is a bigger increase?

Chief Judge DAWSON. Right.

Senator PROXMIRE. Can you tell us why the Tax Court needs an increase next year more than double inflation, as I figure it?

Chief Judge DAWSON. I think the primary reason is the increase in the number of cases, and our need to set more trial calendars, have more judicial officers working with those cases and try to dispose of them.

Senator PROXMIRE. What would happen, judge, if we denied that and simply kept you at the same level you were at in 1985? As you know, there is a strong feeling in the Senate on the part of many people that we ought to freeze all budgets.

Chief Judge DAWSON. Yes; I do know that, and of course we will abide by whatever is the will of the Congress, naturally, but we think that we can get greater productivity if we have this increase, which we think is a modest one.

Actually, the amount of redetermined deficiencies as a result of these cases which we hear brought in about $660 million, which is 25 or 26 times the amount of our appropriation.

Senator PROXMIRE. You figure that for every dollar you are provided extra here, you are going to bring in an extra $25?

Chief Judge DAWSON. I think so. That has been the history in past years, Senator Proxmire.

Senator PROXMIRE. I know the IRS request is exactly the same as last year.

Chief Judge DAWSON. That is true. They plan to cut back, it is my understanding, on various administrative services, but according to the Bureau of National Affairs publication today, it states that the IRS plans to broaden its audit activity and its examinations and appeals divisions will be increased. They plan to swell the number of agents.

Senator PROXMIRE. That makes a lot of sense. That will bring in more money. Can't you adjust your operation so that you can bring in that $25 and cut some of the travel or some of the other appropriations?

Chief Judge DAWSON. What happens, as I was explaining to the chairman, is that when the IRS increases its audits—and more deficiencies are determined—a certain proportion of those, and almost a steady percentage, will automatically come into the Tax Court, and that is what has kept increasing the Tax Court's pending case load each year.

I think that if there are more audits, there will be more cases coming into the Tax Court. We have got to get them on trial calendars, and we have got to get our judges working on them to dispose of them.

Senator PROXMIRE. So you are saying if we did pass something like what the Treasury proposes, and Bradley-Gephardt and Kemp-Kasten, we could practically dispose of your operation?

Chief Judge DAWSON. I don't advocate that, but I think it would curtail the number of cases coming into the Tax Court if we can get the law simplified.

Senator PROXMIRE. Thank you.

Thank you, Mr. Chairman.

Judge STERRETT. Senator, I don't think I would underestimate the ingenuity of the American taxpayer, whatever the law.

Senator PROXMIRE. That is true, but the simplified tax law should help.

Judge STERRETT. Yes.

Chief Judge DAWSON. It might be tough on tax lawyers and accountants and even judges.

Senator PROXMIRE. Even the judges. You are retiring in June, aren't you?

Chief Judge DAWSON. Yes.

Senator PROXMIRE. You can look on this with a greater equanimity.

Chief Judge DAWSON. Senator Proxmire, the Tax Court has been a great part of my life. This is my 23d year. I have been at it a long time. It is my 38th year in Government service, counting military service in World War II. It has been enjoyable, but there is a time to leave and a time to stay.

Senator PROXMIRE. You have done a fine job.

Senator ABDNOR. Thank you, Senator.

ADDITIONAL COMMITTEE QUESTIONS

Judge, we have a few other questions, but we will submit them in writing so we can move along here.

Chief Judge DAWSON. We will be glad to supply the answers.

Senator ABDNOR. We are sorry to see you go.

Chief Judge DAWSON. I am going to miss you. As I said before, you have been a great friend of the court.

Senator ABDNOR. Judge Sterrett, we look forward to working with you.

He is a new judge.

Senator PROXMIRE. Yes; I knew. You are an Eli, aren't you?

Judge STERRETT. No; I went to Amherst.

Senator PROXMIRE. That is even better.

Judge STERRETT. I think so.

Senator PROXMIRE. You have a colleague from Yale?

Judge STERRETT. Yes.

[The following questions were not asked at the hearing but were submitted to the court for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

In a May 1984 report (GAO/GGD-84-25), GAO identified several areas in which the U. S. Tax Court could improve its operations and made corresponding recommendations to accomplish this through administrative changes. These recommendations are related to five major topics: case scheduling, Court decentralization, opinion productivity, Court costs, and automation of Court activities. These questions cover each of these areas plus other related areas about which the committee may wish additional information.

CASE SCHEDULING

The Tax Court, in response to GAO's recommendation, has significantly increased the number of cases it schedules for trial when it goes to the various trial cities. Nonetheless, even with record case closings in fiscal 1984 of about 34,000 cases, the Tax Court backlog has reached 60,000 cases as of January 1, 1985.

Question:

What steps is the Court planning in fiscal year 1986 to help deal with the growing backlog?

Answer:

The Court has taken the following steps: (1) increased the management, handling and disposition of tax shelter cases by making early assignments of large related groups to specially assigned judges and special trial judges; (2) substantially increased the number of trial sessions and the number of cases and trial hours placed on such sessions (for example, trial hours on two-week sessions have more than doubled in the past two years); (3) in the Fall Term of 1985 the Court will concentrate its efforts on trial sessions in 9 major cities with 60 percent of the pending case inventory; and we will dispense with trial status requests but give more advance notices of trial; (4) the Court has better distributed the workload between judges and special trial judges; (5) most "tax protestor" cases will be handled by using summary procedures; and (6) there will be an increased use of bench opinions.

In a recent report entitled A State Court Perspective on Case Management in the U. S. Tax Court, which was prepared by the National Center for State Courts, it is stated:

> The Court has taken extraordinary steps in recent years to cope with increasing filings, an exploding backlog and lengthening case lives. Few, if any, aspects of the litigation process have escaped scrutiny and, in many cases, action. An effort has been made to reduce the number of excessively old pending cases. Separate tracks have been created for dealing with smaller cases, as well as cases involving tax protestors and shelters. Efforts have been made to expedite opinions including obtaining authority to issue bench opinions accompanied by an increasing use of that authority. Administratively, the Court has expanded its management staff and actively is applying available technology in an effort to

improve processing of the Court's business. And, the Court generally has emphasized case management resulting in a remarkable increase in productivity, measured by dispositions which increased from 18,906 in 1981 to 28,945 in 1983 to 37,098 in 1984.

This is neither the time nor place to catalog the Court's progress in detail. To do so would merely tell the Court what it already knows. It also would be repetitive since Judge Dawson, while serving as Chief Judge, has ably summarized those efforts in recent reports to the Congress and the Court's 1984 Judicial Conference. It is, however, appropriate at this time to acknowledge these efforts because they reflect the Court's commendable dedication to reducing backlogs and delays. No delay reduction plan, even if well conceived, can succeed without that commitment.

One reason that GAO found for the growing backlog was that judges' time on the trial sessions was not being fully utilized because in many sessions most cases would settle and available trial time would not be needed. Thus, in those sessions, more cases could have been scheduled which would have resulted in even more cases being closed at minimal additional cost.

Question:

Does the Tax Court plan to further increase the number of cases being set for trial?

Answer:

Yes, the Court has steadily increased the cases set for trial in an effort to fill as much as possible the available trial time at each session. We are now placing as many as 700 to 800 trial hours on two-week sessions. Settlements have increased and case dispositions have increased. There has been more constant and active pre-trial management by our judges. Special trial judges have also been used in pre-trial actions.

Question:

An important contributor to the Court's backlog is cases arising from IRS' efforts to control abusive tax shelters. What action is the Court taking or planning to deal with this problem?

Answer:

We are concentrating on the early identification and assignment of large related groups of tax shelter cases. A substantial number of precedent opinions involving a great variety of tax shelters have been issued during the past year. More pressure is being put on the parties to be bound by the precedent opinions and to dispose of similar cases by settlements. The Chicago experiment of assigning all tax shelter cases in that area to one judge has been successful in disposing of a large number of cases.

Question:

How many additional tax shelter cases does the Court anticipate receiving this year?

Answer:

Based on the best estimates provided to the Court by the Internal Revenue Service, we expect to receive from 15,000 to 20,000 new tax shelter cases during the fiscal year 1985.

COURT DECENTRALIZATION

In last year's budget request, the Tax Court sought funds to allow it to station a special trial judge permanently in Los Angeles to help deal with the backlog there.

Question:

Has the Court begun its decentralization experiment? What have been the results so far?

Answer:

Yes, the Court began its decentralization experiment on January 2, 1985, at Los Angeles, California. A special trial judge and staff are stationed there. A second special trial judge will be temporarily assigned there in April. All small tax cases in the Los Angeles area are being heard at regular monthly sessions. Later all regular cases under $10,000 in amount will be heard there. The results during the first three months have been excellent. The work is being handled expeditiously, and we have received a favorable public response.

Question:

Does the Court plan any further expansion to the experiment in this budget?

Answer:

No, the Court wants to try the experiment in Los Angeles for eighteen months and then evaluate its effectiveness. Any further decentralization will await the outcome of the present experiment.

OPINION PRODUCTIVITY

One of the Tax Court's concerns about GAO's recommendations was the impact of the increased scheduling of cases and the ability of the judges to issue their opinions promptly. In this regard, GAO suggested that the Court appoint a committee of judges to address the opinion productivity issue. The Court agreed with this recommendation. In addition, the Congress has now given the Court authority to issue oral (bench) opinions. This eliminates the need,

in those cases where it is used, for the parties to write briefs and for the judges to draft and review written opinions.

Question:

Has increased case scheduling correspondingly increased the opinion backlog of the judges?

Answer:

Yes, just as the Court predicted it would in its initial response to the GAO report. At this time last year there were 650 cases under submission to the judges for the preparation of opinions, while this year there are 744 cases awaiting opinion.

Question:

Has the judges' Committee on Opinion Productivity helped to reduce the backlog?

Answer:

Probably not, but the committee has made several helpful suggestions. The Chief Judge has exerted some pressure urging greater productivity by those judges who have had cases under submission for a long time.

Question:

Is the Court using its bench opinion authority? What impact has this had on the opinion backlog?

Answer:

Yes, the number of bench opinions rendered by the Court in the fiscal year 1983 was 112. In the 1984 fiscal year bench opinions were rendered in 338 cases (131 regular cases and 207 small tax cases). Thus, our judges and special trial judges are continually increasing their use of bench opinions to speed the disposition of cases. This is having some impact on the opinion backlog; but, as more cases are placed on trial sessions, the judges are picking up more cases for opinions.

COURT COSTS

Question:

In how many locations is the Court now conducting trials? Are you planning any increase or decrease in locations?

Answer:

The Court is now conducting trial sessions in 80 cities. Based primarily upon the strong recommendation made in the GAO report that the Court decrease the cities where it holds trial sessions, the Court has eliminated trial sessions in 22 cities where there are only a few pending cases and where the city is located within 100 to

125 miles of one of our leased courtrooms. This action has been taken although section 7446, Internal Revenue Code, provides that the Court should sit at such times and places "with as little inconvenience and expense to taxpayers as is practicable."

One trial location at Westbury (Long Island), New York, has been added because the case inventory there is high, and the IRS represented to us that it would be convenient for a large number of petitioners.

Question:

How much are you spending to rent courtroom space outside of Washington, D.C.?

Answer:

During fiscal year 1984 the Court paid $1,085,000 to the General Services Administration for rent on 32 courtrooms located outside Washington, D. C. In fiscal year 1985, rent on these courtrooms is estimated to be $1,484,000.

Question:

How many cities?

Answer:

The Court currently maintains courtrooms in 32 cities throughout the country.

Question:

What efforts has the Court made in the last year to reduce the number of courtrooms leased?

Answer:

Because of the unavailability of courtrooms in the 32 major cities where the Court has leased space, we have made no efforts to reduce such leased space. In some locations, such as Buffalo, Little Rock, and Reno, we are experiencing great difficulty in borrowing courtroom space in federal, state or local facilities.

Question:

How much does the Court spend on travel in connection with its trial sessions?

Answer:

The Court spent $487,000 in fiscal year 1984 for transportation and per diem expenses for judges and trial clerks to conduct its trial sessions

Question:

How much was spent on first-class airfare?

Answer:

$44,000 was spent for first-class airfare during the fiscal year 1984 compared with $144,000 spent for coach class airfare and other types of transportation. Only regular judges are authorized by law to travel first-class based on their own certifications. The Court discourages first-class by its judges to most cities (particularly those east of Chicago) in which cases are heard. About one-third of the judges trips were first-class last year.

COURT AUTOMATION

In its report GAO suggested that the Tax Court consider automation of its case processing operations. The Court has studied the issue and recently awarded a contract for a computer system.

Question:

When will the Court's new computer system be operational?

Answer:

It is anticipated that the Court's new computer system will be operational in October 1985. The system will be installed and testing will begin in October 1985. (It should be noted that the Court will not input data on pending cases at the time of start-up of the system; therefore, the operational system will not for some time reflect the entire caseload of the Court.

Question:

What will it do for the Court?

Answer:

The Tax Court had a study conducted by a GSA-approved consultant, American Management Systems, to determine which computer system and software would best serve the Court's automation needs. Representatives of the Tax Court also visited the Court of International Trade in New York City, as recommended by GAO, to examine that Court's case processing system. The Tax Court followed the recommendation of AMS to purchase a minicomputer and software that would allow the Court to capture Tax Court case data.

The Tax Court will realize substantial time savings from the computer system with the elimination of a number of manual steps in processing cases, the automatic generation of notices, and the elimination of redundant data capture. In addition, the Tax Court will have more rapid access to data allowing for more timely responses to inquiries for case information. The system will provide a vital management function for the Court as well by providing statistics not readily available at the present time. With the filings of new cases increasing 25% a year, this type of automated information retrieval system is essential for the Court to operate efficiently.

SOUTHERN CALIFORNIA CASELOAD

Question:

Over 30% of your cases develop in Southern California. Is there a theory as to why?

Answer:

There are probably several reasons why the case inventory in Southern California is high. First, more audits of tax returns have been generated there. Second, it is an area with a high ratio of "tax protesters" and tax shelter promoters. Third, the taxpayers in that area tend to contest taxes more often.

TAX SHELTER CASES

Question:

Tax shelter cases have gotten much attention lately. Is the IRS effort paying dividends? What has it done to your caseload?

Answer:

In my opinion the vigorous audit and enforcement program of the IRS regarding abusive tax shelters is achieving beneficial results. It has maintained firm, consistent and pragmatic settlement and litigation policies. Overall the IRS tax recovery rate with respect to tax shelter cases has been high. The IRS has prevailed in most litigated abusive tax shelter cases.

The audits of tax shelter cases have resulted in a substantial increase in the Tax Court caseload--now about one-third of the pending cases. Over the next three years the tax shelter caseload is expected to increase further.

Question:

You assign all tax shelter cases to one Judge. How has that procedure worked? Do you foresee doing future case "specialization" of this type?

Answer:

Various large groups of particular types of tax shelter cases are specially assigned to individual judges. About 130 groups have already been identified and assigned to judges. Thus far, the procedure has worked effectively. Specialization will continue in this area of litigation. In addition, our special trial judges specialize in handling virtually all small tax cases and other cases where the deficiency amount is less than $10,000, as well as so-called "tax protester" cases which are disposed of by summary procedures. Also, as I mentioned in my statement, one judge has been assigned all windfall profit tax cases.

Question:

You have noted a massive warehousing of tax shelter cases. Do you think petitioners and their counsel are doing this with the idea of getting a favorable ruling by wearing down the Court?

Answer:

No, I don't think that is the reason for warehousing tax shelter cases. The Court is coping with the workload and test cases are being heard and decided. In the past, I think the "warehousing" resulted from low interest rates charged on tax deficiencies compared to interest rates in the market place. Petitioners were not anxious to settle or try their cases as long as there existed a major differential in interest rates. This has been corrected by Congress. Additional interest and penalties have helped the situation. Another factor that resulted in "warehousing" was the erroneous perception of some petitioners that they would get a better settlement offer from IRS if they waited. Unfortunately for them, that has not happened.

FY 1984 COMPUTER SUPPLEMENTAL

Question:

Last year the Committee approved a supplemental for computerization costs. What is the status of the modernization? Are you seeing results yet?

Answer:

Following the completion of GSA's requirements for making a computer system procurement, the U. S. Tax Court signed a contract on January 18, 1985, with a vendor to supply the Court with a computer system and software. The contract also provides for modifications to the software to meet the Court's specific needs.

GSA has begun work on the site preparation for the Court's computer room pursuant to a work order issued to them, and the Court has been meeting with the computer system vendor to develop the specifications for the software modifications which must be programmed.

The Court anticipates that the computer room will be completed, the computer equipment installed, and the software ready for testing by the Court by the last quarter of fiscal year 1985. The actual start-up of the system is planned for the first quarter of 1986.

OBSERVATION ON THE TAX CODE

Question:

You noted in testimony before other committees that "the best tax law is one that everyone understands." I think we can certainly agree on that point. As one who deals daily with the complexity of the current code, could you please give us your observations as to what we must do with the tax code?

Answer:

I am sure a book could be written on this subject. But, briefly, what is needed in a tax code is simplicity, equity and economic efficiency. It should be simple in structure with lower current marginal tax rates while evenly and fairly distributing the tax burden among taxpayers. It should have a broader tax base, with deductions essential to avoid hardship and to protect economic security. It should also be efficient and responsive to market conditions in business and consumer activities. It seems to me that something must be done to eliminate most tax breaks or preferences. In the 1986 fiscal year these breaks alone will exceed $400 billion, according to the Joint Committee on Taxation, which is about twice the projected deficit for that year.

The perception of inequity is so widespread that the Commissioner of Internal Revenue has warned that it could provoke disobedience and be detrimental to our voluntary compliance system. I firmly believe that tax simplification and reform will give the taxpayers more confidence and trust in the system. This, in turn, will result in less litigation.

CASELOAD

Question:

Caseload seems to be the biggest problem the Court faces. Should filings be restricted? How do you believe we should proceed?

Answer:

Since the Tax Court is the only non pre-payment judicial forum, it would be difficult to restrict access to it. However, a taxpayer could be required to take his proposed tax adjustments to the Appeals Division of the IRS before filing a petition in this Court. Some workable provision for the exhaustion of administrative remedies would be advisable.

It might also be possible to prohibit access to the Tax Court to any taxpayer who files no income tax return or an inadequate or incomplete return which raises meritless objections.

Question:

Special trial judges hear small tax cases and certain other cases. The small cases have been raised from $5,000 to $10,000 I believe. Will this have an impact on the Court? Should it be raised even higher?

Answer:

Yes, the increase in the jurisdictional limit will mean that more petitioners will opt to have their cases handled as small tax cases. This will speed the disposition of such cases. It will also result in more cases being handled by our special trial judges.

No, the Court believes that $10,000 is probably the outer limit for small tax cases. That deficiency amount represents substantial tax adjustments and sometimes complex issues.

SPACE PROBLEM

Question:

The Court has experienced overcrowding in your current building. I know you have been working with GSA on the problem. Has it been resolved?

Answer:

Yes, the space problem is being resolved. With the assistance of this Committee and GSA, our special trial judges will be moved to the Judiciary Square Building at 633 Third Street, N. W. (one block from the Tax Court building) in May. That will alleviate crowded conditions in the Tax Court building.

PERSONNEL COSTS

Question:

I assume the 5% reduction has been incorporated in your personnel costs. What is the total savings accumulated by the reduction?

Answer:

The 5% reduction has not been incorporated into the Court's personnel costs. The total savings accumulated by the reduction would be $539,000 for fiscal year 1986.

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

STATEMENT OF LOREN A. SMITH, CHAIRMAN

ACCOMPANIED BY:

STEPHEN L. BABCOCK, EXECUTIVE DIRECTOR
RICHARD K. BERG, GENERAL COUNSEL
JEFFREY S. LUBBERS, RESEARCH DIRECTOR
CAROLE D. IANNELLI, SPECIAL ASSISTANT TO MR. SMITH

PREPARED STATEMENT

Senator ABDNOR. We are going to next hear from Loren Smith, Chairman of the Administrative Conference of the United States. It is good to have you back.

Mr. SMITH. Mr. Chairman, thank you for the opportunity to come here. It is always a pleasure to come to what I think is a worthwhile effort, to seek funds. Part of the success of the Conference is interactive. We are an agency that does not have our own agenda, but responds to the agendas of the Congress and the President and those agencies that exist.

Mr. Chairman, let me submit my statement for the record. I won't read the statement.

Senator ABDNOR. Without objection, the whole statement will be made a part of the record.

[The statement follows:]

STATEMENT OF LOREN A. SMITH

My name is Loren A. Smith, and I am the Chairman of the Administrative Conference of the United States. I am accompanied here today by Stephen L. Babcock, the Executive Director of the Conference, by Richard K. Berg, our General Counsel, by Jeffrey S. Lubbers, our Research Director, and by Carole D. Iannelli, my Special Assistant. I am pleased to have this opportunity to appear before you today in support of the President's fiscal year 1986 budget request for the Administrative Conference. Our request is for $1,450,000, slightly less—by $18,000, to be exact—than our request for the current fiscal year. The President has also proposed a fiscal year 1985 pay raise supplemental request in the amount of $12,000, which we hope you will approve.

The Administrative Conference is an advisory agency with the mission of recommending to the President, the Congress and the Federal agencies, ways to improve the fairness and efficiency of the administrative procedures and processes that the Federal agencies use. These administrative procedures and processes include those used by the agencies to conduct rulemakings, to take action on an informal basis, and to hold agency hearings. The Conference also advises the Judicial Conference of the United States on matters of administrative law relating to judicial review of agency decisions.

The Conference's advice is given principally in the form of formal recommendations that are debated and adopted by vote of its 91 members. These voting members of the Administrative Conference, apart from myself, are 90 volunteers, 50 from the various departments and agencies, and 40 from outside the government. These 90 persons are the government's top legal officers, the leading academics in the field of administrative law, and others from private life who are knowledgeable concerning governmental processes.

Formal Administrative Conference recommendations, once adopted, are published in the Federal Register, and are transmitted by the Chairman of the Conference to the Congress or to the agencies that the recommendations concern. As examples of the issues addressed in these formal recommendations, the seven that have been adopted since we were here before you this time last year address the following issues.

The first proposes procedures that the Administrative Conference believes will aid the process of selecting sites for large-scale industrial development projects. Another deals with product recall procedures, a third with the Sunshine Act, and the fourth advocates the use of negotiation in hazardous waste cleanups under the Superfund

program. All four of these recommendations were adopted at the Plenary Session (the semi-annual meeting of all of our members) held in June of 1984.

In December of 1984, another three recommendations were adopted. The first of this group addresses the problem of Federal preemption of State regulatory actions. It calls on Congress to consider the area more fully when enacting new legislation, and it urges agencies to improve and regularize the procedures that they use when adopting regulations pursuant to such legislation. The second is agency-specific; it addresses a situation at one agency, the International Trade Commission. The recommendation suggests ways to deal with the disclosure of confidential business information submitted by businesses having cases before that agency. Finally, the Administrative Conference recommended a number of procedures for Federal agencies to use in handling tort and contract claims submitted by members of the public. The Conference thought that these procedures would make the process both fairer and more efficient.

With that description of our recently-adopted formal recommendations (the texts of which are listed as Appendix A to this testimony), I will give you a bit more information about the personnel involved in our activities.

The Conference is headed by a Chairman, myself. The Chairman is an advice-and-consent appointee with a term of five years. The Chairman presides over meetings of the membership. He also heads the Office of the Chairman, the permanent staff, which has, at the moment, twenty employees. The Conference also has a 10-member Presidentially-appointed Council, consisting of five government officials and five from outside the government. The Council's function is like that of a corporate board of directors.

Government members of the Conference, of which there are forty-four, are designated by the major departments and agencies. They are typically department or agency general counsels, commissioners, assistant secretaries, or the like. The thirty-six public members—those from outside the government—are appointed by the Chairman with the consent of the Council. They serve for terms of two years, also without pay. A total of fifty members are thus Federal officials, and the other forty-one members are from outside the government—members of the public selected for their expertise in administrative law or their knowledge of government processes. Because of the prestige of being a Conference member, the government receives, without cost except for travel expenses, the services of corporate general counsels, leading law professors, private

practitioners, and others with a wide variety of backgrounds, accomplishments and perspectives.

The process by which the Administrative Conference develops recommendations like the seven we described at the outset of this statment is as follows. The Chairman initially decides to pursue a particular topic on the basis of interest by Conference members, Members of Congress or others. When a topic has been defined, the Chairman's staff begins the process of finding a consultant—typically a law professor who already has some knowledge about the particular subject. The consultant will interview agency officials, review the literature, and write a 100 to 300 page report on the problem. The staff Research Director and one or more of the staff Committee Liaison Attorneys work closely with the consultant, and with the chairman and the members of the appropriate Conference standing committee, throughout this process. When the report is prepared it is given to the members of the standing committee (all members serve on one of these committees), and the committee develops a proposed recommendation. The Council then reviews the recommendation prepared by the committee and, if it believes the proposal has received sufficient attention, the Council places it on the agenda of the next semi-annual general meeting—or Plenary Session.

At the Plenary Session, the proposed recommendation is thoroughly debated by the members. Often recommendations are amended and occasionally they are referred back to committee or killed outright. If a recommendation is adopted, however, it is published in the Federal Register, and is sent to the agencies or to the Congress, as appropriate. The past recommendations of the Conference are also set out in the Code of Federal Regulations.

Implementing Conference recommendations is another important part of the activities of the staff of the Office of the Chairman. The Office maintains a separate file on each past recommendation, in which information received from all agencies concerned with that recommendation is kept. Most implementation efforts, however, are responsive: since the Conference has advisory powers only, the staff must remain alert to indications that one or more agencies, or a Congressional committee, is interested in a problem that relates to one or more past recommendations. The staff, or the Chairman personally, will then ensure that the interested body is aware of the Conference recommendation and will offer assistance. Examples of testimony on implementation in the past year include giving to interested Congressional Committees the views of the Conference on S. 1080, the omnibus regulatory reform bill, H.R. 3688, a Contract

Disputes Act bill, S.J. Res. 135, concerning the legislative veto, and S. 774, amending the Freedom of Information Act.

Appendix B, a recent Washington Post story on one of our recommendations adopted this past December, reports on an example of a recent implementation effort, favorably mentioning the efforts we are now undertaking to involve the responsible departments themselves in making improvements in the present methods of claims processing, in furtherance of a recommendation adopted this past December.

The approach to implementation reflected in this news article raises one interesting point. Since our governing statute does not give us powers to compel compliance with our recommendations, but rather reflects a conscious decision by the Congress not to give the Administrative Conference anything more than the tools of persuasion, our implementation activities are of necessity confined to attempting to encourage agencies to undertake such efforts. But, on balance, I cannot say that it should be otherwise. For if the departments and agencies were afraid of the Administrative Conference, we would not enjoy the tremendous amount of cooperation from which we now benefit. And our efforts to obtain information from the agencies leading to recommendations would largely be fruitless if the Administrative Conference were seen as a threatening institution.

The Office of the Chairman also receives requests from agencies and Congressional committees for its views on the procedural aspects of pending legislation, in areas in which the Conference has not adopted a formal recommendation. In such situations, the Chairman or staff of the Office of the Chairman will testify, based on their own expertise and/or on research reports contained in the Office's excellent library of administrative law materials. An example of this kind of work is our on-going efforts in connection with the Equal Access to Justice Act. We recently gave our views on issues relating to the reauthorization of this Act to Congressman Kastenmeier, the Chairman of the House Judiciary Committee's Subcommittee on Courts, Civil Liberties and the Administration of Justice, and are in the process of responding to questions on the same subject from Senator Grassley, Chairman of the Senate Judiciary Committee's Subcommittee on Administrative Practice and Procedure.

On occasion we receive more formal requests from agencies or from Congress to play an advisory role. For example, the recommendation on siting of industrial facilities, adopted in June of 1984, was the result of a project that the House Appropriations Committee, at the behest of our House Subcommittee, directed the Conference to

undertake in the Report accompanying the 1983 House Treasury—Postal Service—General Government appropriations bill.

The third major category of Administrative Conference activities come under the heading of clearinghouse activities. The Office of the Chairman is mandated by the Administrative Conference Act to "arrange for interchange among administrative agencies of information potentially useful in improving administrative procedure." 5 U.S.C. 574(2).

One of the current activities in furtherance of this goal is the Council of Independent Regulatory Agencies, created in April of 1982 at a meeting with the President. This group, which I head, meets, usually bimonthly, to discuss matters of interest to the 14 chairmen of the principal regulatory agencies who are its members. The Office also conducts monthly meetings on topics of interest to those engaged in regulatory activities, called Colloquia on Regulatory Design in Theory and Practice, which are funded by contributions from several Departments and agencies. The Conference has received continuing encouragement from the other Federal departments and agencies who jointly sponsor these colloquia with the Conference. The summary report of the colloquia held in the year 1983-1984 is attached hereto as Appendix C.

In 1983, the Office of the Chairman also formed the Agency Management Information Group, open to all non-Cabinet, line agencies interested in management issues such as the Reform '88 initiatives. A steering committee of this group also meets on a monthly basis. I am in addition a member of the President's Cabinet Council on Legal Policy and the President's Cabinet Council on Management and Administration, and my activities on these bodies fall under the heading of clearinghouse activities.

The Office also hosts various groups from foreign governments who are interested in questions of governmental process and hence in the work of the Conference. This expression of interest in the work of the Conference continued during the year 1984, and we were visited by officials from the Governments of Japan, Canada, Australia and the Federal Republic of Germany.

I also had the privilege of having been chosen as a member of the United States delegation to the Anglo-American Legal Exchange. I was thus included in the group of eight persons, led by the Chief Justice of the United States, who spent two weeks in the United Kingdom in July of 1984 studying administrative law issues in that country. The counterpart English delegation, led by Lord Bridge of Harwich (the functional equivalent of a Justice of the Supreme Court of the United States) visited the United States in

September of 1984, and I and my staff assisted in making arrangements for this group of distinguished visitors.

Finally, as in past years, the staff attorneys of the Office of the Chairman engage from time to time in special projects associated both with clearinghouse and with implementation activities. Last year I reported to you that we had produced a manual on Rulemaking in Federal Agencies, for use both by lawyers and non-lawyers involved in the process. I am pleased to supplement that report by noting that during the past year, that manual proved to be so popular with the audience to which it was directed that the Government Printing Office had to run a second printing.

This past year's effort, which I think will be just as useful, involved the production of a second edition of a work entitled Directory of Administrative Hearing Facilities, a copy of which is attached to this testimony as Appendix D. This guide, which was produced with small contributions from user agencies, lists hearing facilities potentially available to administrative law judges in cities throughout the United States. Listing these cities aids administrative law judges in holding hearings in the field, which is more convenient to the interested members of the public, with the expenditure of less time and money.

Having concluded my description of the past year's activities, I turn to the subject of our request for an appropriation for the fiscal year 1986. As I said at the outset, the President has requested for the Conference a figure of $1,450,000, a very slight decrease as compared to the Conference's budget for 1985. The Conference proposes to use this appropriation, if granted, basically to continue its current activities in 1986 at their 1985 level. This 1986 request will give the Conference sufficient resources to commission larger, empirically-based reseach projects. It also will give the Conference the ability to obtain research reports in a more timely fashion. I have included as Appendix E a recent list of research projects now underway, and we will continue to commission new projects of this same type during the coming fiscal year. Our other activites, described under the general headings of implementation activites and clearinghouse activities, will also continue at their present level.

As the Conference is presently constituted, its recommendations, each year,

produce more in savings to the government and the public than the Conference costs. The increase in resources that we received last year from this Subcommittee, which has allowed us to begin replenishing our pipeline of on-going research projects, reflects, we would like to think, your confidence in the value of the Administrative Conference as an agency.

We hope our work will continue to merit your approval.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared testimony. Thank you very much for taking the time to hear us. We will be happy to respond to any questions that you or any other Members of the Subcommittee may have.

[CLERK'S NOTE.—Appendix A is being retained in the subcommittee files.]

APPENDIX B

[From the Washington Post, Feb. 18, 1985, "Washington Business," p. 23]

AGENCY ADMONISHES U.S. LAWYERS

(By Daniel B. Moskowitz)

Government lawyers are under pressure to stop acting so much like lawyers. The Administrative Conference of the United States—the agency made up of Federal officials and private citizens that is supposed to set general Governmentwide standards on administrative matters—is calling for a lot less reliance on legal technicalities when the various departments handle claims filed under the Federal Tort Claims Act. Too often now, the Conference says claims that have real merit are tossed out because a "t" is not crossed or an "i" not dotted. And the Conference members say that is the wrong way to go about administering a statute that is specifically designed to give a hand to the ordinary citizen.

The FTCA lets individuals sue the Government for any kind of routine injury. But, to minimize the amount of litigation, it requires the would-be plaintiffs first to explain their case to the agency involved, and to see if the matter can be settled without going to court. Most are. But the Administrative Conference wants the individual claims officers to be a lot less hard-nosed about processing these applications for damages. The group is advocating that the officers:

—Stop rejecting claims because of technical errors, and instead point out to the applicants what the problems are and give them a chance to correct them.

—Give the applicants extra time, beyond the normal filing deadlines, to make the corrections, when the law gives the bureaucrats the authority to be flexible.

—Allow a claim that is mailed by the deadline, even if it actually arrives at the agency after the cutoff date.

—Be a lot more open about sharing information in their files relating to the accident or other problem that gave rise to the claim—even when there is a legal excuse for keeping the data confidential.

—Tell applicants why they were turned down and spell out for them the appeals procedures open to them. The Administrative Conference specifically wants the claims officers, when fielding phone calls for applicants whose claims have been rejected, to tell them whether their complaints add up to a request for reconsideration and, if not, what they should do to make the request more formal.

The report takes special aim at the Justice Department, which—because it handles the FTCA cases that get to court—generally supervises what other agencies are doing under the statute. Too often, the Conference members say, Justice bounces back to the agencies tentative settlements worked out with applicants because big bucks are involved. And that, in turn, makes the claims officers wary of settling serious cases. If the damages were so extensive that a bid settlement is fair, the claims officer should

make the offer and Justice should not pounce on it, the Administrative Conference says.

Some of the suggested changes merely are meant to make it easier for men and women in the street to know what to do when they have a claim against Uncle Sam. The simplest: Publish a list of who in each organization handles what sort of claims, and how that person can be reached by phone, and then send the list to all claimants.

Prestigious as the Conference is, its recommendations often merely sit on the shelves of the various agency law libraries, gathering dust. Conference Chairman Loren A. Smith, however, is planning to put an extra push behind the FTCA report. He's trying to get Justice to set up an internal task force to examine the way the law is now administered. He also is seeking to establish an ad hoc committee of the claims officers in the individual agencies, to get them to pull together to show more tolerance of claimants' legal errors.

But there's only so much that claims officers can do: The Conference members say that in some cases, the underlying laws that authorize payments need themselves to be changed. For one thing, many contain money limits that have become outdated because of inflation. The report recommends that such limits be raised across the board. But beyond that, the Conference wants Congress to ease some of the tight time restrictions that are written into the law.

In the major legislative fights in Washington, technical changes in the FTCA will never loom large. The biggest hurdle facing the Administrative Conference is not opposition, but indifference. But if the changes every happen, they will mean a lot to a lot of the very folks the law was meant to aid.

INTRODUCTION OF ASSOCIATES

Mr. SMITH. Let me introduce the members at the table with me. To my left is Steve Babcock, Chief of Staff and Executive Director; Carole D. Iannelli is here, my special assistant and Deputy Director. To our right is General Counsel Dick Berg, and to his right is Jeff Lubbers, our Research Director.

Dick has been with the Conference longer than any other member of the staff, and is one of the true assets of the Federal Government in the knowledge of administrative law.

Senator ABDNOR. That is very good coming from your boss.

Mr. BERG. That is very kind.

BUDGET REQUEST

Mr. SMITH. We support the President's budget, which is a request for $1.45 million, a reduction from last year. We also support the President's request for $12,000 in the supplemental budget for the pay raise. This would be about 50 percent of the pay raise increase that was given.

The Conference, just to summarize, has over the last year held two plenary sessions and adopted seven recommendations. I think they go to problems seriously facing the country.

In this type of budget dilemma and deficits, it is a moral obligation, and I know you have felt this very strongly, to help make Government work better and more efficiently and get more bang for the buck. We owe that to the taxpayers. We are in a situation now that any business that was in the situation of the Federal Government would long ago have been in receivership.

So we have this obligation.

CONFERENCE RECOMMENDATIONS

The Conference, I think, is an important institution in that it helps deal with real and concrete problems. In our June session, we adopted four recommendations, one dealing with siting of large scale industrial development projects, and coordination between State, local, and Federal efforts in developing those siting plans so that we would be putting less burden on business and the economy and still meet the needs of adequate land planning.

We had a recommendation addressed to the procedure on product recalls.

We looked at the Sunshine Act and at what effect it was really having on the actual operations of the agencies and recommended some fine tuning that we feel would improve the quality of service the citizens get from their Government.

Finally, we looked at the very thorny political problem of the superfund and how we might improve the enforcement of that statute by a technique called regulatory negotiation, which we applied to the area, rather than going out and engaging in expensive litigation. It is in the interest of everyone to try to settle things quickly.

Senator ABDNOR. Very good. Does it look good?

Mr. SMITH. I think so. The EPA has indicated they are going to experiment with two particular problem areas with regulatory negotiation, and I think the study on the superfund which was a separate issue, was well received by EPA and environmental groups and by industry. I wasn't sure what we did right or wrong, but everyone seemed to like it.

In our December plenary session, we came up with three additional recommendations. One dealt with Federal-State preemption, and when the Federal Government should and shouldn't preempt State programs and what criteria should be used. We normally deal with these problems on an ad hoc basis.

We adopted a specific recommendation dealing with the International Trade Commission, with respect to their handling of confidential business data. It was well received. They sent us a letter that they are implementing some of the recommendations and requirements.

Finally, we looked at the problem of how the Federal Government handles tort claims of citizens and made recommendations that the Justice Department has indicated will be very helpful.

CLEARINGHOUSE ACTIVITIES

Those were our formal activities. I also serve on the President's Cabinet Council on Administration. We have a meeting with the President later on this afternoon.

We have been doing clearinghouse functions. The agency management information group brings agency managers together, and we had a good program when Chuck Parkinson was our speaker, and talked about the managers and the process of how Congress interfaces with

their questions. I am not saying that because Chuck is here, but Chuck said he had to get back and we promised him we would not run beyond 4 o'clock, and he was still surrounded by questioners at 4:05, and as he went out the door.

Senator ABDNOR. Did he give you the right answers?

Mr. SMITH. They were always the right answers. Sometimes we liked them, and sometimes we didn't, but he well represented the views of the Senate.

It has been a pleasure, in closing, to work with your staff. They have always done their jobs with dignity and honor, and a sympathetic ear to what makes Government work better.

Senator ABDNOR. Thank you for the comments and compliments. These people are going to be hard to live with. We are happy to hear it. We think they do good work, too. We appreciate your comments.

That will make you work all the harder, won't it, Chuck?

In 1986, your request is slightly below. That will make Senator Packwood very happy. I assume the 5-percent pay reduction makes up that total?

BUDGET REDUCTION

Mr. SMITH. That isn't the plan. If the 5-percent pay reduction occurs—the reduction, sir, resulted from an OMB effort which was itself pursuant to the statute to encourage agencies to achieve economies in administrative services, and reductions have come out of the areas called administrative services.

Senator ABDNOR. For the record, will you give us a list of the members of the Conference?

Mr. SMITH. Yes.

[The information follows:]

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Mr. SMITH. One of the joys of working with the Conference is that we have a diverse membership. There are 90 regular members and 30 liaison members and senior fellows. All of them serve without pay from the Government. Private members devote thousands of dollars worth of billable legal time a year.

Senator ABDNOR. That has been that way for a long time?

Mr. SMITH. Yes; really from the inception, and we have a broad membership which makes the Conference a delightful place to work and also, I think, a useful entity for the Government.

Senator ABDNOR. You have no authority, do you, to enforce your recommendations?

IMPLEMENTATION OF RECOMMENDATIONS

Mr. SMITH. No; we are sort of a friendly nag. No one really has—Congress, of course, has the authority to enforce our recommendations, and in several cases has done so. Our recommendation on limiting races to the courthouse, addresses a statutory matter. Congressman Hall and Congressman Kindness have cosponsored a bill to implement that recommendation.

Cabinet officials have put various recommendations into effect. The International Trade Commission is implementing our recommendations in its own rules.

Senator ABDNOR. What would you like to see done to make it move better, your recommendations enforced and put into effect? Do you know of any proposal that would be good?

Mr. SMITH. There have been a number of proposals seeking to give the Conference political power to make decisions. The Carter administration wanted to make us the overseers of the administrative law judges, and I think Senator Kennedy had a proposal to give the Conference procedural review authority.

I tend to think that while these have interesting aspects to them, the genius of the Conference is that it doesn't have any power, and, there-

fore, we can work with the agencies in a way that OMB or GAO can't. We are agency-friendly, to use the computer term, user-friendly, and, therefore, it gives the agencies confidence that they will have input and we are not going to be breathing over their shoulder. I think persuading is a good discipline.

Senator ABDNOR. Very good.

EXECUTIVE REDUCTION PROGRAM

The Office of Personnel Management is in charge of implementing the GS–11 to GS–15 Executive Reduction Program. Will the Conference be affected?

Mr. BABCOCK. It will not, sir. We are too small.

Sir, the reductions contemplated under that program would amount to a small fraction of one person. That is the reason.

Senator ABDNOR. There are some agencies in which GS–11's, GS–12's, and GS–13's are the balance of the work force.

Mr. BABCOCK. Yes, sir; and they are a substantial part of ours, too, but we have a total permanent staff of 16, so when you talk of 2 or 3 percent reductions, it gets down to somebody's arm.

Mr. SMITH. Nobody has been willing to make that sacrifice.

Senator ABDNOR. We do have some concerns ourselves, and wonder if we did the right thing in giving this consideration. Some agencies could have quite a problem with this. We had some law enforcement areas that gave us some concerns. Could we work with you on this?

Mr. SMITH. We would be delighted. This is a problem of interest to me, and I have talked at the Cabinet level with Don Devine on that particular concern. It bothers me when we do across-the-board management programs. They have a large benefit, and with 2 million employees you can't do anything without a management technique. However, they often cut indiscriminately and when you indiscriminately cut 10 percent of everybody's funding, it hurts the ones who are lean more than those that are fat.

Senator ABDNOR. That may come up this year with us. This category that is of a discretionary type took cuts when other agencies didn't.

Anyway, it is nice to know that Mr. Mills and Mr. Parkinson have taken into account your concerns.

I congratulate you on the work you folks do. Thank you for coming, and we will see you from time to time, I am sure.

Mr. SMITH. Senator, thank you very much. It has been a pleasure for us to be here.

Ms. IANNELLI. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you.

ADVISORY COMMITTEE ON FEDERAL PAY

STATEMENT OF MARTIN L. DUGGAN, CHAIRMAN

ACCOMPANIED BY LUCRETIA DEWEY TANNER, EXECUTIVE DIRECTOR

PREPARED STATEMENT

Senator ABDNOR. Well, our next witness will be Martin L. Duggan, Chairman of the Advisory Committee on Federal Pay.

Senator ABDNOR. Like our first witness, this will be your first appearance here before the subcommittee.

Mr. DUGGAN. Yes, sir.

Senator ABDNOR. You came aboard last year. You are intimately aware of the day-to-day workings and the proposals that the committee has made. We welcome you. If you want, your entire statement will go into the record. You can proceed now as you care to.

Mr. DUGGAN. Thank you, Mr. Chairman.

As you noted, this is my first appearance before you, and I am grateful to you for your invitation. I look forward to working with you and your associates.

We will submit our entire statement for the record. I will keep our remarks brief.

We would also like to enter our 1984 report to the President, which is our main function, into the record, and perhaps you would find it of interest to include in the record a comprehensive record on the history of the Federal pay processes, which appears in the current issue of the Labor Law Journal under my name.

Senator ABDNOR. We would like that. How big is that report?

Mr. PARKINSON. It is not too big.

Senator ABDNOR. We certainly want your article in there. We will put your report into the record at the same point as your prepared statement.

[The information follows:]

STATEMENT OF MARTIN L. DUGGAN

Good afternoon. I am Martin L. Duggan, Chairman of the Advisory Committee on Federal Pay. This is my first appearance before your honorable body since my appointment by President Reagan on May 3, 1984. I appreciate your invitation and look forward to my association with this Committee.

In these days of budget crisis you may be pleased to know that the Advisory Committee on Federal Pay is the smallest agency in the government. It was established by the Federal Pay Comparability Act of 1970 (Public Law. 91-656) as an independent body to advise the President on pay matters. The Committee's recommendations apply to pay affecting approximately 1.4 million Federal employees covered by the General Schedule, those employed in the Department of Medicine and Surgery of the Veterans Administration, and the Foreign Service of the United States. The Committee has three citizen-members from the private sector, appointed by the President to serve 6-year staggered terms. While authorized to have three paid staff employees, we have contented ourselves to employ two. Both are exceptionally qualified women and their performance is outstanding.

In recent years, the Committee annually has returned a portion of its modest budget to the Treasury. We think that is a proper example to set.

Last May, on being sworn in as Chairman, I outlined two major objectives: First, to enhance the Committee's effectiveness in the pay setting process, and, secondly, to contribute towards improving the climate between the Committee, other government bodies, and employee representatives. I have actively sought counsel from a wide range of groups--members of Congress, the Pay Agent (the Directors of the Office of Management and Budget and the Office of Personnel Management and the Secretary of Labor), unions, professional associations, scholars of public administration, members of the public, media representatives, and all who are willing to share their thoughts with us. I have extended this invitation in preparation of the Advisory Committee's issuing a spring 1985 report. This report, now in progress, will set out the problems and offer guidance for the future.

In issuing the 1984 Advisory Committee report, submitted to the President on August 24, 1984, I believe we have taken concrete steps toward advancing the concept of fairness. With your permission, I would like to submit the entire 1984 Committee report for the record and take this opportunity to highlight just a few key points.

By way of explaining some of the procedures under the law, let me summarize briefly. The Pay Agent, under direction from the Office of Personnel Manage-

ment, has direct responsibility for the survey design, although the actual data collection is done by the Bureau of Labor Statistics. The survey now includes 3,200 private sector establishments and covers 25 occupations in 105 levels of responsibility common to both the Federal Government and private industry. The BLS data are turned over to OPM to calculate the difference between the private sector and Federal pay. In 1984, the paylines showed that an increase of 18.3 percent would be necessary to bring Federal workers' pay to the private sector level. The Pay Agent submitted these findings to the President and the Advisory Committee. Generally, the Advisory Committee has concurred with the Pay Agent and further refined its recommendations.

However, in 1984 the Committee departed from its previous reports because it did not recommend implementation of the full comparability figure, 18.3 percent. Rather, it was the Committee's belief that an 18-percent pay increase was unrealistic in Fiscal 1985 and perhaps never attainable. Instead, the Committee recommended that a fair adjustment would be 5.5 percent, the increase granted to private sector white-collar workers during the June 1983-84 period, as measured by the BLS Employment Cost Index. We recommended this increase be put into effect in October 1984, the month provided for by the Federal Pay Comparability Act of 1970.

The report on pay comparability submitted by the President's Pay Agent stated that the survey on which pay comparability is based should be expanded in scope. The Pay Agent agreed that the expansion should include smaller sized establishments (those with 50 employees to be included in the 1985 survey and 20 employees in the 1986 survey), additional industries and occupations, and coverage of State and local government workers. The Advisory Committee strongly supported this proposal. We looked forward to the broadened data collection effort in the belief that this would restore lost confidence in the pay setting system. To our dismay, we later learned that this survey expansion was once again to be postponed for lack of funds.

Since the 1984 report was issued, I have taken the opportunity to set forth a brief history of the pay setting process and outline a few observations and thoughts for the future. This was published in the January 1985 issue of the Labor Law Journal. With your permission, I would like to submit this article for the record.

The Advisory Committee is concerned with long-term goals. I believe that all the problems of pay and the Federal retirement system need to be addressed

and that decisions must be based on an understanding of total compensation--pay and benefits.

Budget and Personnel. The appropriation request for the Advisory Committee in Fiscal Year 1986 is $219,000, or $1,000 less than our appropriation for the preceding Fiscal Year 1985. Our agency, along with all other agencies, was reduced by 5 percent for salaries in anticipation of the 5-percent pay reduction scheduled for October 1985.

The Fiscal Year 1986 Advisory Committee budget will cover salaries and travel expenses of staff and Committee members when they are engaged in Committee work and rent and operating expenses of our headquarters offices.

Although our mediation role has fallen into disuse, the Committee is hopeful that it can be revived. It sincerely believes in employee involvement and participation. One of the Committee's objectives is to encourage active dialogue between the Pay Agent and members of the Federal Employees Pay Council, composed of five representatives of unions in the Federal sector.

Last summer the Committee met with representatives of the Pay Council and other employee organization representatives before preparing its report to the President. Their views were incorporated into the 1984 report and given a great deal of consideration in making the Committee's final recommendations.

In its operation, the Committee has always exercised financial restraint and has operated with a modest budget. As a small agency, funds are a minimum of discretionary spending and the current budget includes no contingency funds for staff or unanticipated problems or studies.

During this coming fiscal year, the staff will spend time analyzing the current issues and be prepared to make recommendations.

This concludes my remarks and I will be happy to answer questions.

JUSTIFICATION

ADVISORY COMMITTEE ON FEDERAL PAY

SALARY AND EXPENSES

For necessary expenses of the Advisory Committee on Federal Pay, established by 5 U.S.C. 5306, $219,000.

General Statement

The appropriation will pay the expenses of the three members of the Committee for such time as they spend on Committee business, the salaries of the Committee's three full-time employees, rent and other expenses of maintaining an office. This budget will also cover the cost of special studies and economic advice as required in order to evaluate proposals affecting annual changes in the pay of 1.4 million Federal white-collar employees and the longer term issues involving Federal compensation policies. The direct compensation bill for white-collar employees totals about $40 billion a year.

JUSTIFICATION OF APPROPRIATION REQUEST, 1986

The Advisory Committee on Federal Pay was appointed by the President in January 1972 as an independent establishment in accordance with the Federal Pay Comparability Act of 1970 (Public Law 91-656). It consists of three members who are not otherwise employed in the Government of the United States. The Committee is responsible for preparing an independent annual report to the President with respect to increases in pay of the approximately 1.4 million Federal employees covered by the General Schedule, those employed in the Department of Medicine and Surgery of the Veterans Administration, and the Foreign Service of the United States. Annual direct compensation costs for Federal white-collar employees now amount to about $40 billion.

In preparing its report, the Committee must consider not only the recommendations of the President's Pay Agent (the Director of the Office of Management and Budget, the Director of the Office of Personnel Management, and the Secretary of Labor) but views of organizations representing Federal employees.

The Advisory Committee has two additional responsibilities, assumed as a result of recommendations of the President's Panel on Federal Compensation in December 1975 and an Executive Order signed on July 20, 1977. The first is a labor relations-mediation role--intended to improve the day-to-day and long-term relationships between the President's Agent and representatives of Federal employees and thus make possible a more satisfactory and smooth decision as to the annual white-collar pay increase. The second involves recommendations to the President regarding changes that should be proposed in Federal compensation policies and practices.

The members of the Committee are paid at a daily rate plus per diem and travel expenses for time spent on Committee business. In addition, the Committee needs funds to pay for special studies on questions relating to its annual report and longer term compensation policy issues, to obtain economic assistance in preparing its annual report and in monitoring relationships between Federal pay and the economy, to obtain assistance in mediating between the Pay Agent and representatives of Federal employees in their on-going negotiations with respect to Federal pay, and for the administrative expenses involved in its activities and maintaining a small headquarters office.

Program and Financing (in thousands of dollars)

Identification code 95–1800–0–1–805	1984 actual	1985 est.	1986 est.
Program by activities:			
10.00 Total obligations	173	220	219
Financing:			
25.00 Unobligated balance lapsing	42	.....	.....
40.00 **Budget authority (appropriation)**	**215**	**220**	**219**
Relation of obligations to outlays:			
71.00 Obligations incurred, net	173	220	219
72.40 Obligated balance, start of year	9	15	19
74.40 Obligated balance, end of year	−15	−19	−21
77.00 Adjustments in expired accounts	1	.....	.....
90.00 Outlays	168	216	217

Object Classification (in thousands of dollars)

Identification code 95–1800–0–1–805	1984 actual	1985 est	1986 est
Personnel compensation:			
11.1 Full-time permanent	87	112	109
11.3 Other than full-time permanent	11	15	18
11.9 Total personnel compensation	98	127	127
12.1 Personnel benefits: Civilian	9	10	11
21.0 Travel and transportation of persons	8	15	16
23.1 Standard level user charges	23	23	23
23.2 Communications, utilities, and other rent	8	8	9
24.0 Printing and reproduction	2	2	2
25.0 Other services	24	33	29
26.0 Supplies and materials	1	2	2
99.9 Total obligations	173	220	219

Personnel Summary

Total number of full-time permanent positions	2	3	3
Total compensable workyears: Full-time equivalent employment	2	3	3

Annual Report of the Advisory Committee on Federal Pay

August 24, 1984

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

The Advisory Committee on Federal Pay has the privilege of submitting its thirteenth annual report to you. The report includes the Committee's findings and recommendations with respect to the Fiscal Year 1985 pay adjustment for the approximately 1.4 million white-collar employees.

The Committee is greatly concerned about the pay setting process because of its departure from the Federal Pay Comparability Act of 1970. The Committee plans to undertake an extensive review of the process and issue a comprehensive set of recommendations in the spring of 1985.

The report now presented is a summary of its findings and should be considered an interim set of recommendations for your consideration.

Respectfully submitted,

Eva Robins
Member

Frank G. Zarb
Member

Martin L. Duggan
Chairman

I. INTRODUCTION

The Federal Pay Comparability Act of 1970 (P.L. 91-656) requires the Advisory Committee on Federal Pay to report annually to the President on its views and recommendations for pay increases. These increases are for the approximately 1.4 million white-collar workers in the Executive Branch of the government. The Veterans Administration's Department of Medicine and Surgery, the Foreign Service, and the military are also linked to the white-collar pay increase. In addition, blue-collar workers, whose pay is set by the Federal Prevailing Rate Systems Act of 1972, have been capped at the white-collar pay increase since October 1978.

The Federal Pay Comparability Act of 1970 was designed to provide an equitable and fair method of setting pay. However, this may mark the seventh year (table 1) that the comparability principle as outlined by the procedures under the Act and as administered by the Pay Agent has not functioned as originally intended.

The President's budget for 1985 provides for a 3.5-percent increase to become effective in January. In past years, Congressional debates have clouded the process; however, this year Congress has decided not to pre-empt the President's right to recommend a pay increase. In accordance with the Pay Act of 1970, the Advisory Committee believes that it has a responsibility to perform and will continue to function as directed by law. It has consulted with the Federal Employees Pay Council and other employee organizations and is issuing its report in a timely fashion.

The Committee believes that the pay setting process should be reviewed and, if need be, changed, in order to become acceptable to the Executive Branch, Congress, the public, and, ultimately, the people working under the system. Although this year's report is brief and concise, it in no way reflects diminished concern. Rather, the Committee plans to issue a comprehensive review of the current pay setting process and a set of recommendations in the spring of 1985.

II. THE 1984 PAY INCREASE

The Pay Agent's report indicates that, on average, a pay increase of 18.3 percent would be granted in October 1984 if the comparability principle operates under the current methodology. The increases shown in the Pay Agent's report range from 17.01 percent at GS-5 to 21.66 percent for GS-15 (table 2). Table 3 presents the amount of increases shown by the Pay Agent to be required to achieve comparability with the private sector by grade over a 13-year period. Past and current decisions not to implement the full comparability increases over the recent 6 years account for this large gap. Last year's 4-percent pay increase, which became effective in January 1984, actually 3 percent when annualized, left an 18-percent gap. The Bureau of Labor Statistics' survey of pay increases for private sector occupations shows a range of increases from 3 to 6 percent, depending on the occupations, for the March 1983-84 period. When calculated against the Federal work force data, the gap results in the current figure of 18.28 percent. This is the current computation of the gap between private sector rates compared to Federal sector rates.

The President's 1983 alternative pay plan provided for a 3.5-percent increase effective January 1984; however, Congress, in its passage of the Omnibus Budget Reconciliation Act of 1983, adopted the House's proposals for a 4-percent increase effective in January. On May 23, 1984, the President signed Executive Order 12477, providing for the 4-percent increase, and the .5 percent was made retroactive to January 1. This marked the first time that Congressional action overrode the President's alternative pay plan for the amount of the increase.

The President's Fiscal Year 1985 budget, issued in January, called for a pay increase of 3.5 percent for white-collar workers effective 3 months later than the October date. A 3.5-percent increase effective in January 1985 is 2.6 percent when annualized. The military increase proposed for January 1985 was 5.5 percent, or 4 percent when annualized.

While the Advisory Committee recognizes that the Pay Agent has found that the appropriate adjustment using the established methodology is 18.3 percent, the members are aware that there is little or no likelihood that this amount will be implemented reasonably soon, if at all. In the past, the Advisory Committee suggested phasing in the gap, then 18.5 percent, over a 3- to 5-year period. This recommendation went unheeded. In the meantime, national deficits have grown, making it more unlikely each year that the full adjustments as shown in the Pay Agent's report and in the Advisory Committee's 1983 recommendations will be made.

In the spring of 1984, the American Federation of Government Employees (AFGE) (AFL-CIO), one of the unions represented on the Federal Employees Pay Council, presented Congress with the amount of increase it believed appropriate for Federal white-collar workers. Using a method that combined the indexes for the Consumer Price Index, Employment Cost Index, Hourly Earnings Index, and military pay, as well as the past year's pay increase, AFGE arrived at a 6.4-percent pay adjustment, to become effective in October. This proposal was developed before the delayed .5 percent was made retroactive to January 1984. If this additional amount had been considered, the proposed increase would be 5.9 percent.

A review of the Consumer Price Index and the pay increases granted Federal workers are shown in table 5. Last year, the difference between the two was less than one-half of 1 percent. This deceleration in the rate of growth of the Consumer Price Index, restraints in wage gains throughout the economy, and moderate increases granted to Federal workers offer a unique set of circumstances. The opportunity now presents itself for re-examining aspects of the Federal Pay Comparability Act and the comparability pay principles to find a system that is acceptable to the general public, the Executive Branch, the Congress, Federal employees, and employee organizations.

III. MEETING WITH EMPLOYEE ORGANIZATIONS

This year, as in the past, the Advisory Committee members met with representatives of the Federal Employees Pay Council and other employee organizations, who were invited to state their concerns:

-- The Senior Executives Association pointed out that the nature of the work performed in the Federal Government has changed dramatically over the past 20 years and has created a greater need for highly skilled professionals. The government is now forced to compete with the Fortune 500 companies but comparisons of pay and benefits clearly show that the private sector offers more. As an example, the SEA cited statistics to show that since July 1979 over 40 percent of the people in the original Senior Executive Service left the government, with over 1,660 of them resigning and another 1,600 retiring. Differences in pay between the public and private sectors are dramatic, according to the SEA representative, who noted that the May 1984 issue of U.S. News and World Report cited 48 executives earning over $1 million or more and another 937 earning between $1 million and $100,000. In summary, SEA stated that, while the pay gap may not be bridged, a responsible step should be made to return to equity.

-- The National Treasury Employees Union, a member of the Federal Employees Pay Council, expressed concern over the changes made in this year's calculation of the comparability data without advance notice or an opportunity to discuss it, specifically the use of medians rather than averages. NTEU called for the elimination of the 18.3-percent gap by implementing the amount this year. NTEU stated it stands ready "to work with the Administration to develop a realistic collective bargaining bill to present to Congress."

-- The Federal Managers' Association, representing blue- and white-collar managers, outlined the organization's convention policy statement on compensation. Included in its statement are:

> "Providing a reasonable comparability raise in October 1984 and beyond.
> "Revisions to the Merit Pay System for GM-13, 14 and 15 employee to provide for full comparability for all 'fully successful' managers and supervisors under Merit Pay.
> "The policy that no supervisor should receive less pay than those supervised."

FMA stated, "We sorely need the private sector and the Federal Government to develop objective and realistic guide lines, policies; and, thereby in this computer age provide unquestioned compensation and fringe benefit data."

-- The Non Commissioned Officers Association of the USA stated that the present proposals for increasing military pay at 5.5 percent across the board is inadequate and that a minimum 10 percent should be implemented, with greater increases for enlisted personnel in pay Grades E-4 through E-9. These greater increases are needed to alleviate compression problems that have been created over four decades.

-- The Retired Officers Association, representing over 335,000 former and active duty officers of the seven Uniformed Services, expressed great concern over the gap between military pay and private survey rates, now 9.5 to 10 percent.

This is the largest gap since the advent of the all-volunteer force in 1972 and may result in an exodus of experienced, highly qualified people, reminiscent of the personnel crisis experienced in 1975, it warned. The Services are not attempting to pay their people wages which are strictly comparable to those paid for in specific private sector careers--for example, commercial pilots, who are paid $90,000; or merchant marine captains, $110,000 to $141,000; rather, the goal is to provide a predictable stable compensation system, one which supports the institutional aspects of service and develops those allegiances and loyalties which will elicit the required dedication of those who serve.

-- The Federal Executive and Professional Association expressed regret that the Pay Agent did not hold its traditional meeting with the Federal Employees Pay Council and other organizations or make its complete Pay Agent draft report available in time to comment on it. It urged the return to comparability and that the gap be phased in over a relatively short period of time. In addition, the Association presented the Advisory Committee with its recently issued publication, "An Agenda for More Effective Government."

-- The Federal Employees Coordinating Committee, a coalition of 16 professional organizations, suggested that, whatever the increase granted this year, it should be distributed by grade on the basis of the comparability gap. For

example, if an average of 4 percent is granted, then it should range from a low of 3.26 at GS-1 to a high of 6.98 percent at GS-15.

-- The Association of Scientists and Engineers of the Naval Air and Sea Systems Command, representing approximately 500 professional employees responsible for the acquisition and maintenance of the Navy's ships, objected to the decision of not granting the engineers, subject to special rates, the same general increase granted all other white-collar workers.

-- The National Society of Professional Engineers, representing more than 75,000 members of whom 12 percent are employed in the government sector, also expressed concern about those engineers under special rates not receiving the general increase. According to its salary survey, Federal median salaries are the third lowest compared to 24 other categories of employees.

-- The Federal Bar Association observed that, because of the Federal Government's pay practices, it has difficulty in recruiting and retaining qualified people and has become a training ground for the private sector.

In written comments to the Advisory Committee, the following was communicated:

-- A statement by the American Federation of Government Employees and the Public Employee Department, AFL-CIO, outlined their concerns. The letter stated, "For all practical purposes, the current process for setting federal white collar pay is dead--not because of flawed methodology, as OPM asserts--but because of a conscious effort by this (and prior) administrations to hold the line of federal outlays at the expense of the federal workers." It urged the adoption of collective bargaining.

-- The Association of Government Accountants cited the annual controversy surrounding the PATC survey and suggested that the Employment Cost Index for salaries and wages be used.

-- The National Federation of Federal Employees commented that the Pay Agent had not provided it with complete information and noted that it, along with other members of the Federal Employees Pay Council, should have been consulted regularly during the development of the annual professional, administrative, technical, and clerical survey. The members did not walk out of previous meetings, according to NFFE, but simply rejected the pay setting approaches presented to them.

-- The National Council of Social Security Management Associations, Inc., a professional organization representing managers of the Social Security Administration in over 1,300 local Social Security districts, urged the President to implement the recommendations of the Advisory Committee.

IV. THE COMPARABILITY ACT AND THE FUTURE

The Federal Pay Comparability Act of 1970 and its predecessor, the Salary Reform Act of 1962, established the principle of paying Federal white-collar workers the average of salary rates in the private sector. The framers of these laws believed that a procedure of annual adjustments tied to survey results would make annual debates unnecessary; however, their hopes were not realized.

Last year, the Advisory Committee recommended establishing a Commission to study the entire pay setting process. In addition, the Committee strongly endorsed a bill in Congress to establish a Centennial Commission to analyze pay and benefits. No action has been taken on any of these suggestions. The Advisory Committee believes it is now appropriate for it to review the pay setting process and issue a comprehensive set of recommendations for the future. This report will be issued in the spring of 1985. It is without precedent that the Committee undertake this interim task but it believes that by setting forth a realistic set of proposals the interest of the Executive Branch, the Congress, the Nation, and Federal employees can be best served.

V. RECOMMENDATIONS TO THE PRESIDENT

1. The Pay Agent report finds that an average increase of 18.3 percent would be called for under the established method for calculating increases. The Committee concurs with the report that the data base should be expanded and recommends that the survey be strengthened and improved to include smaller sized establishments, a broadened occupational base, and State and local government workers' salaries. The form, substance, and degree of that expansion will be examined by the Advisory Committee in the preparation of its spring 1985 report. We believe it is necessary to restore confidence in the data collected by having the analysis made on an impartial, factual, and realistic basis.

2. This year the Advisory Committee believes that the pay increases for the 1.4 million Federal white-collar workers, and others whose pay systems are linked, should be based on the Bureau of Labor Statistics' Employment Cost Index (ECI). The ECI is a series produced quarterly and measures changes in total compensation and wages and salaries only. Increases for white-collar private sector wages and salaries were 5.5 percent in the June 1983 to June 1984 period. In addition, this increase falls within the range found by the Bureau of Labor Statistics' annual survey of professional, administrative, technical, and clerical pay, a range of 3 to 6 percent, depending on occupations in the private sector. Thus, the Advisory Committee recommends that a 5.5-percent pay increase become effective October 1984.

3. The Advisory Committee on Federal Pay is seriously concerned about the future of the Federal Pay Comparability Act of 1970 and the pay setting process. As a result of this concern, it plans to undertake a comprehensive review of the issues and prepare a set of recommendations for consideration. By issuing its report in the spring of 1985, it seeks to provide a framework for a compensation system that can be acted upon in October 1985.

Respectfully submitted,

Eva Robins
Member

Frank G. Zarb
Member

Martin L. Duggan
Chairman

Table 1. Chronology of General Schedule Salary Increases, January 1971 to October 1984

Date	Recommended by Agent		Put into effect--		Remarks
	Average	Range	Average	Range--	
January 1971	5.96%	None	5.96%	None	Comparability measurement in effect at time called for no variation by grade.
January 1972	6.6	None	5.5	None	Economic Stabilization Act reduced increase below comparability.
October 1972	5.14	None	5.14	None	Strict comparability called for increases from 3.5 to 7.9 percent. Court overturned postponement to January 1973, proposed by President.
October 1973	4.77	4.55-5.25%	4.77	4.55-5.25%	Congress overrode alternative plan delay to December.
October 1974	5.52	5.46-5.59	5.52	5.46-5.59	Congress overrode alternative plan delay to January.
October 1975	8.66	None	5.0	None	Alternative plan not overridden.
October 1976	5.17	4.24-1/8.98	5.17	4.24-8.98	
October 1977	7.05	None	7.05	None	Strict comparability called for increases from 6.26 to 9.8 percent. Uniform percentage increase agreed to by Pay Agent and Federal Employees Pay Council.
October 1978	8.4	6.14-1/13.27	5.5	None	Alternative plan not overridden.
October 1979	10.38	8.8-1/15.43	7.0	7.0-2/9.89	Alternative plan not overridden.
October 1980	3/ 12.69	10.2-1/20.91	9.1	9.1-4/10.41	Alternative plan not overridden.
October 1981	15.1	12.08-1/23.33	4.8	None	Budget reconciliation provided increase.
October 1982	5/ 17.1	14.98-1/31.07	4.0	None	Alternative plan not overridden.
January 1984	21.5	17.82-1/36.25	4.0	None	President's alternative plan provided 3.5 percent; however, in April Congress passed the Omnibus Budget Reconciliation of 1983, which provided for an additional .5 percent.
October 1984	18.3	17.01-21.66	-----Not known-----		

1/ Maximum increase permitted under existing ceiling.
2/ Increases in excess of 7 percent given only to Grades 1 and 2.
3/ 13.46 percent, assuming ceiling is raised.
4/ Increases in excess of 9.1 percent given only to Grades 1 and 2.
5/ 18.5 percent, assuming ceiling is raised.

NOTE: Historically, wages for blue-collar Appropriated Fund employees (450,000) have been based on 135 individual geographical wage surveys conducted by both union and agency representatives. For Nonappropriated Fund employees (170,000), surveys are conducted in 142 areas. Although surveys have been conducted, blue-collar workers have been subject to the same wage cap, by Congressional action, as white-collar workers since October 1978. Where survey results show lower increases than the cap, the lower increases were implemented.

Prior to 1980, military pay was linked to white-collar increases. In October 1980, however, they received 11.7 percent and in October 1981, 14.3 percent. By October 1982, the link was re-established.

SOURCE: A "Decade of Federal White'Collar Pay Comparability, 1970-1980," and Advisory Committee on Federal Pay reports.

Table 2. Increases in General Schedule Pay Required in October 1984 for Comparability With March 1984 Private Enterprise Rates

GS Grade	Comparability gap-- Percent of private sector pay	Comparability gap-- Dollars	Step 1 pay levels to provide comparability
1	17.44%	$ 1,685	$10,196
2	17.26	1,881	11,516
3	17.13	2,101	12,967
4	17.05	2,347	14,546
5	17.01	2,623	16,269
6	17.03	2,932	18,136
7	17.09	3,278	20,164
8	17.20	3,665	22,353
9	17.36	4,100	24,723
10	17.56	4,586	27,274
11	17.82	5,131	30,031
12	18.48	6,419	36,194
13	19.33	8,024	43,351
14	20.39	10,007	51,683
15	21.66	12,442	61,434
Average	18.28		

SOURCE: Pay Agent's 1984 Report to the President.

Table 3. Percent Increase of General Schedule Salary Scales Required for Comparability With Private Sector, 1/ Selected Grades and Dates

Date	GS-1	GS-5	GS-11	GS-15	Average, all grades
January--					
1971 --------	0	0	0	0	0
1972 --------	1.1	1.1	1.1	1.1	1.1
October--					
1972 --------	1.63 above	.81 above	.48	2.29	0
1973 --------	0	0	0	0	0
1974 --------	0	0	0	0	0
1975 --------	3.10	3.40	3.86	4.50	3.4
1976 --------	0	0	0	0	0
1977 --------	.03	.71 above	.38 above	2.80	0
1978 --------	.62	.86	2.53	7.37	2.7
1979 --------	0	1.73	2.52	7.9	3.1
1980 --------	0	2.1	2.9	10.8	3.3
1981 --------	7.56	6.95	8.98	17.68	9.8
1982 --------	12.9	11.88	11.51	26.03	13.9
1983 2/ -----	16.8	14.9	14.3	31.0	16.8
1984 3/ -----	17.44	17.01	17.82	21.66	18.28

1/ Based on Step 1 rates; comparability as computed by Pay Agent on the basis of BLS data for the private sector as of April of each year in which Federal pay increase was effective in October (as of preceding June in case of Federal increases effective in January). Gaps apply only to the year in which they are shown and are not cumulative.

2/ After a 4-percent across-the-board increase granted in January 1984 (not annualized).

3/ Before any October 1984 pay increase.

SOURCE: Advisory Committee on Federal Pay's report, "A Decade of Federal White-Collar Pay Comparability, 1970-80," updated from Pay Agent's annual reports.

Table 4. Changes in Federal Pay Compared With Changes in Other Pay Scales and the Consumer Price Index, 1970-84

Measure	Percent increase, 1970-84	Estimated addition to Fiscal 1984 Federal compensation costs if white-collar pay had increased at the same rate as other measures (billions of dollars)
Federal white-collar salary scales: Actual increase	112	-
If other measures were used:		
Postal pay scales	227	$21.6
Federal blue-collar pay: Actual increase	170	10.9
Private sector white-collar pay as measured by BLS	145	6.2
Military pay	149	6.9
Consumer Price Index	163	9.6

Table 5. Wage and Consumer Price Index Increases, 1978-84

	1978	1979	1980	1981	1982	1983	1984
	(March to March changes, in percent)						
PATC Survey	7.9	7.8	9.1	9-11	9-10	7.1	3-6
Employment Cost Index							
Private nonfarm--							
Wages and benefits 1/	NA	NA	NA	10.7	2/7.8	6.4	5.7
Wages and salaries only	7.5	7.8	9.1	9.3	8.1	5.4	5.0
White-collar workers--							
Wages and benefits 1/	NA	NA	NA	10.8	6.5	6.6	6.3
Wages and salaries only	7.1	7.3	9.2	9.3	8.3	5.6	5.6
CPI urban wage earners and clerical workers	5.6	10.3	14.6	10.5	6.5	3.7	3.5
Pay increases granted Federal white-collar workers	5.5	7.0	9.1	4.8	4.0	3/4.0	

1/ First published in 1979.

2/ Reflects a deceleration in compensation costs and wage increases that began in 1981.

3/ A 4-percent pay increase was effective in January 1984, 3 months late. On an annualized basis, this represents a 3-percent pay increase.

APPENDIX A

ORGANIZATIONS DISCUSSING THE PRESIDENT'S AGENT'S REPORT
WITH THE ADVISORY COMMITTEE ON FEDERAL PAY

Federal Employees Pay Council

National Treasury Employees Union--
Robert Tobias

Other Employee Organizations

Association of Scientists and Engineers of the Naval Air and Sea Systems Command--
Dave Toms

Federal Bar Association
Jay Reining

Federal Employees Coordinating Committee--
Ronald Stern

Federal Executive and Professional Association--
Karl Grimm
Bob McNichol
Lily Mary David

Federal Managers' Association--
Bun Bray

National Society of Professional Engineers--
Robert Blake

The Naval Civilian Administrators' Association--
Jack Day

Non Commissioned Officers Association of the USA--
C. A. "Mack" McKinney

Retired Officers Association--
John F. Wanamaker

Senior Executives Association--
David Burckman

[From Labor Law Journal, Jan. 1985]

January, 1985 Vol. 36, No. 1

The Bottom Line on Federal Pay

By Martin L. Duggan

Chairman, Advisory Committee on Federal Pay

On December 6, 1984, President Reagan unveiled his fiscal year 1986 budget, which called for a five-percent pay cut for the 1.4 million white-collar workers employed by the federal government. A procedure for setting pay was established by the Federal Pay Comparability Act of 1970 (Public Law 91-656); yet, over the past seven years the mechanism set forth by the statute has been put aside and increases have been determined by Presidential discretion.

In defending his proposal to cut pay by five percent, the President cited private sector employees who have been asked to take pay cuts to keep their company in business. Accepting cuts as a quid pro quo for maintaining jobs is not a new development in the private sector and, in 1982, many federal workers did the same thing. With 1982 budget cuts, employees in a number of agencies were "furloughed," a term used to describe a situation when people are directed to take time off without pay. In two agencies, workers were given the option of reducing their work hours and pay in order to save jobs, and they volunteered to take the pay reduction.[1]

Now the bottom line facing federal workers appears to be a five-percent pay reduction, at worst, or no increase in fiscal year 1986, at best.

Federal pay issues have concerned policy makers for a long time. This article reviews the history of the pay setting process and its limitations, outlines other options available, describes how the private sector survey is conducted, and offers a few general thoughts for the future.

The federal government is the nation's largest employer. By way of gauging its size, a review of *Fortune* Magazine's annual listing of the top 500 U.S. industrial corporations shows that, if all the employees of the largest 42 companies were combined, these would equal the five million federal work force of white- and blue-collar, military, and Postal workers. General Motors, the largest employer with 691,000 workers from the Chairman of the Board on down, equals only the civilian employment in the Department of Defense's Army and Navy, not counting the Air Force. As a result of normal turnover, the federal government brings on board some 40,000 people each month just to fill vacancies,[2] and this is after reducing non-Defense employment by 78,000 in the 1981-84 period.[3] Despite its size, federal civilian employment has remained relatively constant at 2.7 million over two decades.

Federal employees are found in over 400 white-collar and 400 blue-collar occupations[4] and perform functions as diverse as launching missiles and submarines, inspecting meat, processing Social Security checks, managing public lands, mediating labor disputes, and collecting taxes. The annual payroll for white collar and

[1] See "The Federal Diary," *The Washington Post*, March 19, 1982, and April 5, 1982.

[2] See "Federal Civilian Workforce Statistics," Monthly Release, U.S. Office of Personnel Management.

[3] *Federal Times*, November 19, 1984.

[4] *Occupations of Federal White-Collar and Blue-Collar Workers*, U.S. Office of Personnel Management, October 31, 1981.

military is one billion dollars,[5] with pay checks spent in every state and overseas as well, representing an important economic component of a community. Although it is large, the civilian payroll has actually declined as a percentage of total federal outlays, dropping from 14.6 percent in 1970 to 8.1 percent in 1983.[6]

The diversity of functions, skills, and responsibilities of these positions makes the task of knowing how to pay workers fair and equitable wages and benefits no easy task. It is a problem that has been discussed since the founding of our nation. Yet, a sound, predictable, and principled system is necessary in order to facilitate recruitment and retention of highly qualified people.

In recent years, federal workers have felt that they have been unfairly criticized and blamed for unpopular programs and unrealized hopes. Supporters of federal workers predict that such repeated criticisms may well produce unresponsive and inefficient government, as a self-fulfilling prophecy.

Recent events may indicate that the tide may be turning, although perhaps not swiftly enough. According to a November 8-14, 1984, poll taken by the *New York Times* (November 19) and CBS News, the public's trust in the government is at the highest point since 1972. More people than in recent years think government is being run for the benefit of all the people, not for the new big interests looking out for themselves. This finding was reinforced by the response to the question, "How much do you think you can trust the government in Washington to do what is right—just about always, most of the time, or only some of the time?" Fully 45 percent responded by saying the government could be trusted all or most of the time compared to only 25 percent just four years ago.

More directly, Presidential Counsellor Edwin Meese III, speaking before the Senior Executives Association/Professional Development League Annual Training Conference in November 1984, praised their role for recent management innovations and promised greater White House consultation with their organization. He suggested that the role of the nonpolitical senior careerist is to provide institutional memory and management advice. He stated that in the future both political appointees and careerists would work together.

While these are only a few examples of how attitudes may be changing, they are the kinds of demonstrations that should be publicized and reinforced on a continuing basis.

Brief History

Over 100 years ago a decision was made to pay federal blue-collar workers wages comparable to those of their private sector counterparts in each locality. This form of comparability continues today; however, the actual implementation of comparable increases has been suspended since 1978, the same year that federal white-collar pay was capped.

For white-collar workers, however, the idea of paying wages comparable to those in the private sector is still relatively recent. During the 1923 to 1945 period, wage rates remained almost unchanged except for minor adjustments in the late 1920s and temporary wage reductions in the Depression years. While adjustments were made during the postwar period, these were primarily cost-of-living increases that tended to favor workers at the lower end of the salary structure.[7]

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[5] Special Analysis, Budget of the United States Government, fiscal year 1985, p. I-9.

[6] Calculated from the U.S. Budgets.

[7] *Wage Chronology: Federal Employees Under the General Schedule Pay System, July 1924-October 1974*. U.S. Department of Labor, Bureau of Labor Statistics, 1975 (BLS Bulletin 1870).

The Classification Act of 1923 was the first federal attempt to achieve a systematic approach of aligning jobs and salaries among the government's various departments and agencies. Although the Civil Service Act of 1883 (Pendleton Act) did provide for open competitive examinations, a probationary period before attaining career status, and selection based on population in the states, it made no attempt to correlate salaries with duties and agencies were free to set their own pay rates. The 1923 Act established the principles that positions would be classified and graded, a sample pay scale would apply to all similar positions throughout the government, the different pay scales and grades would be related, and the central agency would be responsible for classifying employees. The 1923 Act remained in effect until 1928, when minimum and maximum rates were provided for most of the grades and a 1941 law initiated automatic within grade salary increases if an employee's conduct and work were satisfactory.

By the 1950s, study groups were formed to analyze federal pay setting methods and, as a result, developed the theoretical and technical bases for the comparability principle. This concept was formalized with the passage of the Salary Reform Act of 1962 (Public Law 87-793), which required the President to submit a report to Congress that compared federal and private sector rates.

The basic reform was initiated in the President's budget message for fiscal 1963 and sent to Congress in 1962. The proposal was based on a joint Bureau of the Budget and Civil Service Commission study of federal pay schedules. The President's message stated that the proposed legislation was introduced because of inequities in salaries paid federal workers in managerial and professional occupations in the private sector and the inflexibility in salary administration. The message pointed out that many of the defects in the salary system were the cumulative result of past congressional action that provided the largest relative pay increases to the lowest grades. The bill enacted provided for higher pay increases for the upper grades and set up special procedures for relating federal salaries to pay in industry and provided for interrelating salary levels among the various pay systems.

Under the 1962 Act, the President was required to direct an agency to submit annual comparisons of federal employees' salary schedules with private sector rates for the same levels of work, based on the Bureau of Labor Statistics' annual surveys of professional, administrative, technical, and clerical pay. After receiving comments from the employee organizations, the President's report to Congress would include recommendations for revising the salary schedule or compensation policy.

New pay schedules, however, required congressional action and, as history has demonstrated, both the President and Congress were reluctant to grant the full comparability increases. This, together with an 18-month time lag between the survey data collection and implementation, meant that federal salaries began falling further behind those in private sector firms.

In order to correct these problems, the Federal Salary Act of 1967 (Public Law 90-206) marked the next step of actually achieving comparability. Immediate and substantial increases in 1968 and 1969 were necessary in order to achieve full comparability with private rates.

As a way of avoiding past problems of political consideration and pay caps, the Federal Pay Comparability Act of 1970 (Public Law 91-656) assigned responsbility for setting pay with the President.

Federal Pay Comparability Act of 1970

The next major step in pay setting was enactment of the Federal Pay Compara-

bility Act of 1970 (Public Law 91-656, dated January 8, 1971). It reaffirmed the concept of comparability by placing primary responsibility for pay setting on the President, created a body known as the Pay Agent, formalized recommendations from employee groups by creating the Federal Employees Pay Council, and established an independent, three-member Advisory Committee on Federal Pay. The law sets forth the following principles for setting pay: "(1) there be equal pay for substantially equal work; (2) pay distinctions be maintained in keeping with work and performance distinctions; (3) Federal pay rates be comparable with private enterprise pay rates for the same levels of work; and (4) pay levels for the statutory pay systems be interrelated."

The Pay Agent consists of the Directors of the Office of Management and Budget and the Office of Personnel Management and the Secretary of Labor. The Secretary of Labor was added with Executive Order 12004, dated July 20, 1977. In establishing the Advisory Committee on Federal Pay, the framers of the legislation sought recommendations from a body of impartial private citizens with expertise in compensation matters.[8]

Over the 14 years of the statute's existence, the principles and procedures outlined by the Act have been breached more frequently than not. During the early years of the statute, attempts were made to follow its guidance and, as the table shows, comparability increases were granted in 1971, 1972, 1973, 1974, 1976, and 1977, although in 1972 and 1977 increases ranged by grade while across-the-board adjustments were implemented.

Since 1978, no comparability pay increase has been recommended by the President. In August 1982, the President recommended that a 3.5-percent increase be effective in January 1983, and in April 1984 Congress decided that the increase would be four percent, with the .5 percent retroactive to January. This, however, was the single time that Congress changed the amount of the increase to be granted.

(see Table)

The law outlined specific procedures to be followed in carrying out its principles. A survey of pay rates for the same levels of work in the private sector was to be conducted by the Bureau of Labor Statistics and reports were to be submitted to the President by his Pay Agent and the Advisory Committee on Federal Pay. The Pay Agent was required to establish a Federal Employees Pay Council, consisting of five members of representatives of employee organizations whose views were to be considered on the issues of survey coverage (including the occupations, establishment size, industries, and geographic areas), comparisons of pay with the same levels of work in the private sector, and the adjustments necessary. Section 5305(c)(1) states: "If, because of national emergency or economic conditions affecting the general welfare, the President should, in any year, consider it inappropriate to make the pay adjustment required by subsection (a) of this section, he shall prepare and transmit to Congress before September of that year such alternative plan with respect to a pay adjustment as he considers appropriate, together with the reasons therefor, in lieu of the pay adjustments required by subsection (a) of this section." The law also provided that, if either House of Congress disapproves of the alternative pay plan, the pay adjustment called for by the Pay Agent and the Advisory Committee will take effect.

The emergency provisions have been used consistently to justify the government's need to fight inflation and hold down deficits, a use not envisioned by the Act. Congress has been unwilling to override the President's alternative pay plans.

[8] The Committee is composed of three individuals from the private sector who are appointed for staggered six-year terms. In addition to the Chairman, the other two members were Eva Robins, attorney-arbitrator, and Frank G. Zarb, General Partner, Lazard Freres.

CHRONOLOGY OF GENERAL SCHEDULE SALARY INCREASES, JANUARY 1971 TO OCTOBER 1984

Date	Recommended by Agent		Put into effect—		Remarks
	Average	Range	Average	Range—	
January 1971	5.96%	None	5.96%	None	Comparability measurement in effect at time called for no variation by grade.
January 1972	6.6	None	5.5	None	Economic Stabilization Act reduced increase below comparability.
October 1972	5.14	None	5.14	None	Strict comparability called for increases from 3.5 to 7.9 percent. Court overturned postponement to January 1973, proposed by President.
October 1973	4.77	4.55-5.25%	4.77	4.55-5.25%	Congress overrode alternative plan delay to December.
October 1974	5.52	5.46-5.59	5.52	5.46-5.59	Congress overrode alternative plan delay to January.
October 1975	8.66	None	5.0	None	Alternative plan not overridden.
October 1976	5.17	4.24-[1]8.98	5.17	4.24-8.98	
October 1977	7.05	None	7.05	None	Strict comparability called for increases from 6.26 to 9.8 percent. Uniform percentage increase agreed to by Pay Agent and Federal Employees Pay Council.
October 1978	8.4	6.14-[1]13.27	5.5	None	Alternative plan not overridden.
October 1979	10.38	8.8-[1]15.43	7.0	7.0-[2]9.89	Alternative plan not overridden.
October 1980	[3]12.69	10.2-[1]20.91	9.1	9.1-[4]10.41	Alternative plan not overridden.
October 1981	15.1	12.08-[1]23.33	4.8	None	Budget reconciliation provided increase.
October 1982	[5]17.1	14.98-[1]31.07	4.0	None	Alternative plan not overridden.
January 1984	21.5	17.82-[1]36.25	4.0	None	President's alternative plan provided 3.5 percent; however, in April Congress passed the Omnibus Budget Reconciliation of 1983, which provided for an additional .5 percent.
January 1985	18.3	17.01-21.66	3.5	None	

[1] Maximum increase permitted under existing ceiling.
[2] Increases in excess of seven percent given only to Grades 1 and 2.
[3] 13.46 percent, assuming ceiling is raised.
[4] Increases in excess of 9.1 percent given only to Grades 1 and 2.
[5] 18.5 percent, assuming ceiling is raised.

NOTE: Historically, wages for blue-collar Appropriated Fund employees (450,000) have been based on 135 individual geographical wage surveys conducted by both union and agency representatives. For Nonappropriated Fund employees (170,000), surveys are conducted in 142 areas. Although surveys have been conducted, blue-collar workers have been subject to the same wage cap, by congressional action, as white-collar workers since October 1978. Where survey results show lower increases than the cap, the lower increases were implemented. Prior to 1980, military pay was linked to white-collar increases. In October 1980, however, they received 11.7 percent and in October 1981 14.3 percent. By October 1982, the link was reestablished. In January 1985, however, the military will receive a four-percent pay increase.

SOURCE: "A Decade of Federal White-Collar Pay Comparability, 1970-1980," and Advisory Committee on Federal Pay reports.

except in one instance, and these emergency provisions have overshadowed the law's intent. (Congress has overridden the President on the timing of the increases in 1973 and 1974.)

The statute's legality, along with some 200 other laws, has been called into question as a result of the U.S. Supreme Court's 1983 ruling that a one-House legislative veto of Executive branch decisions is unconstitutional.[9] Section 5305(c) of the Pay Act includes both the alternative pay plan and the one-House veto, and the American Federation of Government Employees and the National Treasury Employees Union filed separate suits against the use of the alternative pay plan by the President.[10] No final decision has been rendered.

Private Sector Survey of Rates

In 1960, the Bureau of Labor Statistics provided the results of the first in its series of annual nationwide surveys of compensation for selected professional, administrative, technical, and clerical occupations in the private sector. The study stated, "It should be emphasized that the study is in no sense calculated to supply mechanical answers to questions of Government pay policy."[11] The survey design was developed by the Bureau of the Budget in collaboration with the Civil Service Commission, the Special Assistant to the President for Personnel Managment, and the Bureau of Labor Statistics. The occupations studied were selected because they were able to be surveyed in industry and representative of occupational groups numerically significant and for which information was found in both industry and the government.

Over the past few years, the survey has come under attack for being too narrow in scope. The survey has been faulted for not including state and local government and small sized establishments. Critics consider its coverage of occupations and industries too limited. The following presents early reasoning for the survey design and the technical changes that have been made as a result of additional information.

Over the past 25 years, the survey has incorporated several technical changes and expansions. It expanded the scope by adding industries, reducing establishment size, and studying more occupations. While some of the occupations initially surveyed have survived, others were discarded as they became obsolete. For example, the first survey looked at wages of switchboard operators, calculating machine operators, office boys and girls, and key punch operators, which have long since been dropped, while others, such as computer operators and computer systems analysts, have been added. During this period, at least 20 jobs were considered for addition by the Pay Agent, but, because of the few numbers found in private firms or the difficulty with matching definitions, they were not used.

The 1984 survey represents the quarter-century anniversary of the annual series. Currently, 25 occupations covering 105 work level categories are surveyed from establishments all over the continental United States. Together these occupations represent about one-third of the total white-collar work force.[12] The minimum size of the establishment studied was either 50, 100, or 250, up to and including the largest, depending on the industry. Approximately 44,500 establishments within the survey employed about 22.7 million workers, and about 45 percent of these workers were professional, administrative, technical, and clerical employees. Establishments actually stud-

[9] *U.S. v. Chadha* (US SCt, 1983).

[10] See American Federation of Government Employees' *Government Standard* (August 1983), and National Treasury Employees Union Press Release, September 1, 1983.

[11] *National Survey of Professional, Administrative, Technical, and Clerical Pay*, Winter 1959-60, U.S. Department of Labor, Bureau of Labor Statistics, Bulletin 1286, pp. iii.

[12] Computed from OPM work force statistics.

ied numbered 3,178, which employed 5.7 million workers.[13]

The Pay Agent's reports for the years 1982, 1983, and 1984 have found the survey deficient in industry and occupational coverage and attempts were made to intertwine the BLS PATC survey with other sources, such as the U.S. Department of Commerce County Business Patterns, to produce reduced comparability rates. However, agreement was reached that the survey should be expanded beginning in 1985 and that wage data would be collected from smaller size establishments, those with 50 employees in 1985 and 20 in 1986. Also, in 1986, state and local governments and additional industry groups would be included.

It should be recalled that the Pay Agent in years past recognized the need to substantially revise the survey by including smaller sized establishment where mostly clerical and technical job matches would be made and for surveying state and local government and nonprofit establishments where occupations in many categories would be found. In 1979, BLS and OPM staff developed such a five-year plan for surveying most of those establishments that had been excluded; however, resource requirements to develop the new definitions and hire and train data collectors were not available for implementation of the plan. In 1984, the resources were again not available for the planned 1985 and 1986 expansion. An estimate of some three million dollars has been placed on the cost of conducting the survey and yet the additional $1.5 million to revise the first phase of the survey is not available.

Other Methods

Comparability of wages was decided to be the most appropriate method of establishing pay when the Salary Reform Act of 1962 was enacted and reaffirmed with passage of the 1970 Pay Act. Comparability of pay (and benefits) is, however, not the only approach.

Congressional action: until 1962, ad hoc congressional action was used as the method of adjusting pay rates. This method proved unsatisfactory, however, because increases became infrequent and pay lagged, creating recruitment and retention problems. Collective bargaining: as a way of setting pay, collective bargaining has been used by the U.S. Postal Service and its major unions since the Postal Reorganization Act of 1970 (Public Law 81-375). Bargaining over wages and working conditions is widely accepted in state and local jurisdictions and is the practice in Britain and Canada. (A more detailed discussion of bargaining appears later.)

Indexation: linking pay to an index can take one of two forms, either tying it to the cost of living or the wage index. In January 1985, both active federal employees and retirees as well as Social Security recipients were granted a 3.5-percent increase, the amount of an adjustment shown by using the Consumer Price Index as an indicator. The 3.5-percent pay increase, however, is only coincidentally linked to the CPI. The amount of the increase was first recommended in the February 1, 1984, President's budget message and later, in August, recommended under the alternative pay plan provisions of the Pay Act.

In its 1984 report to the President, the Adivsory Committee recommended that, as an interim measure, federal pay be linked to the Bureau of Labor Statistics' Employment Cost Index for white-collar private sector wages and salaries only. During the June 1983 to June 1984 period, the Index rose 5.5 percent. The index reflects the wage increases granted in the general economy.

Constitutional amendment: during the 98th session of Congress, a bill (S.J. 1) was introduced proposing an amendment to

[13] See BLS PATC Survey, 1984.

the Constitution for fixing compensation of Members of Congress. The proposal would establish a commission every two years to fix the annual rate of pay and take the decisionmaking out of the hands of Congress. *Bipartisan commission:* one effective way of handling problems is for the President and Congress to name a bipartisan body of experts to look at federal pay and recommend increases.

The concept that pay as well as benefits should be based on comparability with the private sector is not new and has been suggested by various groups, including the Advisory Committee,[14] over the past two decades. The General Accounting Office,[15] the President's Panel on Federal Compensation (Rockefeller Panel),[16] the Federal Personnel Management Project (a task force of President Carter's Reorganization Project),[17] and the Reagan Administration's bill, the "Federal Pay Comparability Reform Act of 1981," have advanced the idea that pay and benefits should be linked to the private sector.

Although general agreement favors the concept, serious problems exist on the benefits to be included, how benefits should be measured or costed, and the firms to be sampled. The Bureau of Labor Statistics surveys large and medium sized firms, the same used to develop pay data, and looks at the level and prevalence of benefits.[18]

An OPM study done in 1981 indicated that, when benefits and pay were combined, a pay increase of 8.8 percent would be justified, compared to the 13.5 percent when pay alone is used.[19] These figures were disputed by an independent review of the Congressional Budget Office that found that fringe benfits for federal white-collar employees were behind those of white-collar employees in the private sector.[20] Because of benefit reductions, primarily in the area of health care, benefits actually trail the private sector. The March 1983 CBO study cited the analysis of health benefits conducted by Mercer, Inc., a private actuarial firm that found federal health benefits inferior to those offered to private sector employees and to large state workers.[21] Hay Associates, an independent consultant, in 1983 also looked at OPM's results and found that federal and private workers were about even.[22]

In 1984, the Hay Group, in response to a request from the House Post Office and Civil Service Committee, conducted another review of pay and benefits. It concluded that now federal workers are lagging behind their private sector counterparts by as much as seven percent.[23]

President Reagan established the President's Private Sector Survey on Cost Control June 30, 1982, and selected J. Peter Grace as chairman. The Commission's mandate was to identify opportunities for eliminating waste and inefficiencies. The Grace Commission, as it became known, issued a report containing some 2,500 rec-

[14] Annual Report of the Advisory Committee on Federal Pay, September 18, 1981.

[15] "Federal Compensation Comparability: Need for Congressional Action," GAO, FPCD 78-60, July 21, 1978, p. 6.

[16] "Staff Report of the President's Panel on Federal Compensation," January 1976, p. 25.

[17] "Federal Personnel Management Project," U.S. President's Reorganization Project, Option Paper No. 6, Job Evaluation, Pay, and Benefit Systems, October 14, 1977.

[18] *Employee Benefits in Medium and Large Firms, 1982*, U.S. Department of Labor, Bureau of Labor Statistics, August 1983, Bulletin 2176.

[19] "OPM Releases Results of First Full Scale Comparison of Employee Benefits in Private, Federal Sectors," OPM News Release, July 1, 1981, of Study, "Total Compensation Comparability, Method, Preliminary Results," OPM Compensation Group, July 1981.

[20] "Adjustments in Federal White-Collar Pay: A Technical Review of Past Proposals and the Outlook for October 1983," Congress of the United States, Congressional Budget Office, Office of Intergovernmental Relations, March 1983.

[21] "A review of the Federal Employees Health Benefits Program," Submitted to the Committee on Post Office and Civil Service, U.S. House of Representatives, July 1982. Prepared by William M. Mercer, Inc., Washington, D.C.

[22] "Comparability of Federal and Private Sector Noncash Compensation," Hay Associates, April 29, 1983.

[23] "Study of Total Compensation in the Federal, State, and Private Sectors," Hay/Higgins Company and Hay Management Consultants, December 4, 1984. Submitted to the Committee on Post Office and Civil Service, U.S. House of Representatives, Reprint 98/16.

ommendations that the Commission calculated at $425 billion in savings.[24]

The report devoted special attention to federal pay and benefits and offered several recommendations. It endorsed the concept of pay comparability but recommended that the survey be expanded to include more federal occupations, smaller sized firms, and state and local government and nonprofit employees. In addition to this survey expansion, the report recommended that the pay rates of clerical and technical jobs be set according to local private rates, recommendations made by others as well.

Over the years, the Advisory Committee also endorsed these changes. As recently as its August 24, 1984, report to the President, it urged that the Pay Agent agree upon expansion and that timetables for the expansion be made and sufficient funding be provided to accomplish the task.

Collective Bargaining

At the same time Congress was considering the 1970 Comparability Act it was also giving Postal workers collective bargaining rights. Congress, in fact, created the U.S. Postal Service with the Postal Reorganization Act (Public Law 81-375) and granted employees bargaining rights over wages. The USPS became an independent agency of the Federal Government on July 1, 1971, just six months after Congress legislated the Fay Act. Postal employees are not the only quasi-governmental groups with the right to negotiate on pay matters. The largest group outside the Postal Service is the Tennessee Valley Authority, with 51,000 employees. The Government Printing Office, with 2,940, the Department of Treasury's Bureau of Engraving and Printing, 1,900, the Department of Interior's Bureau of Mines, and other smaller groups also enjoy collective bargaining rights.[25]

The framers of the Federal Pay Comparability Act stopped short of giving bargaining rights over wages to the 1.4 million white-collar workers. However, the Act stated, "To resolve differences concerning the comparability process, the administration's proposal provides for consultation with employee organizations by the President's Agent on the entire pay adjustment process, including survey coverage, the salary comparison process, and the adjustments in Federal salaries required to achieve comparability with private enterprise salaries . . . . It is our view that attempts to resolve differences regarding the pay setting process should first be made by the two parties involved. A provision for this purpose should be built into the early stages of the process. Under the administration's proposal, this would be done by consultation between the President's Agent and the many diverse employee organizations. The functions of the proposed Advisory Committee then become one of considering and resolving differences. Since this would be an independent group they would be able to make an impartial judgment with respect to the differences that may be presented in the annual report." [26]

Until about 1978, unions representing a large part of the work force were actively participating in the discussions and involved in the changes to the survey. Since that time, however, unions and other employee representatives have not had a forum, except through the Advisory Committee and Congress.[27] Rather than

[24] "President's Private Sector Survey on Cost Control," A Report to the President, Submitted to the Executive Committee for consideration at its meeting on January 15, 1984

[25] "Comparison of Collective Bargained and Administratively Set Pay Rates for Federal Employees," GAO, FPCD 82-49, July 2, 1982, p. 21

[26] "Compensation in the Federal Classified Salary System," Hearings Before the Subcommittee on Compensation of the Committee on Post Office and Civil Service, House of Representatives. Prepared statement of Robert E. Hampton, Chairman, U.S. Civil Service Committee, p. 75

[27] The Federal Employees Pay Council reacted to President Carter's alternative pay plan of 5.5 percent (comparability showed 8.4 percent was appropriate) by resigning. No meetings were held until December 21, 1982, and February 9, 1983, to discuss approaches to setting pay. On February

place the blame on either side, the Advisory Committee believes that an important role exists for these groups and that they should be active in discussions of the survey expansion and in other issues that affect benefits as well.

Collective bargaining over wages and benefits is permitted in 40 states and the District of Columbia, and 10 states permit strikes under certain conditions.[28] Those that prohibit strikes resolve issues with final and binding arbitration. While other countries may grant bargaining rights to their federal employees, notably Britian[29] and Canada,[30] along with the right to strike, the policy thus far for the vast majority of U.S. federal workers is to provide limited bargaining rights. These rights are restricted to working conditions and matters that in the private sector might be relegated to a less serious category. Whether it is because of uncooperative relations or because it is endemic in a system that permits only lesser matters for bargaining, experts in the field believe that grievances are brought to arbitration and appealed to the courts at an alarming and unthinkable rate when compared to the private sector. A study committee should be formed to reveal the underlying causes and seek alternatives.

The Advisory Committee believes that a policy prohibiting strikes by federal workers is appropriate; however, a need exists to encourage worker participation in decisionmaking. Experience in the private sector has demonstrated that employee involvement programs are effective in improving morale and productivity, and these benefits can be transferred to the federal sector as well.

Observations and Recommendations

A better image of the federal worker by the public should be a goal and the Administration is encouraged in its effort to promote cooperation between appointed officials and careerists. Further, federal workers should be instilled with a sense of pride in their mission and sense of accomplishments by both appointed and career managers.

Comparability is only one method for setting pay, yet this approach is favored by many groups, including the Grace Commission. The Advisory Committee believes in the principles outlined in the Federal Pay Comparability Act of 1970 and would like to see them once again implemented.

While comparability is widely endorsed, the survey on which pay rates are based has been severely criticized for not reflecting the total economy. The Pay Agent's 1984 agreement to add occupations, reduce the establishment size, and incorporate state and local government workers would go far in eliminating the criticism and reestablish comparability as a guiding principle.

Until such time that the survey is expanded, the Advisory Committee considers its options limited. Future recommendations should be based on what it believes is the fairest of all methods at this time—changes in the Employment Cost Index for wages and salaries of white-collar workers in the private sector. Although the ECI does not provide for levels of pay, it is an accurate gauge of the increase taking place in the private sector and could be used for two or three years while the full survey is conducted

(Footnote Continued)

22. the Pay Council wrote to the Pay Agent announcing a recess of discussions because of differences.

[28] "Summary of Public Sector Labor Relations Policies," U.S. Department of Labor, Labor-Management Services Administration, March 1981. Subsequent to the report's release, Ohio enacted a comprehensive public sector law. Ten states permit strikes under limited conditions—Alaska, Hawaii, Idaho, Illinois, Minnesota, Montana, Oregon, Pennsylvania, Vermont, and Wisconsin.

[29] Peter Cappelli, "Comparability and the British Civil Service," British Journal of Industrial Relations, March 1984, Vol. XXI, No. 1.

[30] Shirly B. Goldenberg, "Strikes Against the Government: An Overview of the Canadian Experience," Industrial Relations Research Association Proceedings, December 1982.

every fourth or fifth year in order to reduce costs and to reflect shifts in occupational wages.

The Federal Pay Comparability Act of 1970 should be revised. It should provide for the addition of the public as well as the private sector; address the one-House of Congress veto, declared unconstitutional by the Supreme Court; and, if January is the new date for increases, provide for that modification.

The Advisory Committee believes that active participation by employee representatives is necessary in order to develop a pay and benefit program acceptable to those who work under the system and who join it. A steadily deteriorating pay and benefit program will witness the free market in action—the most capable will leave and the best will not be recruited. It is a real choice and is one that will have lasting effects.

Finally, the Advisory Committee believes that considerations about the size and function of the government are outside its jurisdictions. But, whether the government employs 1.4 million or fewer white-collar workers, it must operate efficiently and effectively with the best talent at a fair price.

SMALLEST GOVERNMENT AGENCY

Mr. DUGGAN. Thank you very much.

Sir, our concern is dealing with fairness to people in the Federal workforce and to their ultimate employers, the taxpayers, and in these days of budget crisis and deficit crisis, I hope that you and your colleagues will be pleased to know that we represent the smallest agency in the Federal Government. Our committee is made up of three citizen members from the private sector, not employed by the Federal Government.

While authorized to have a staff of three, we content ourselves to have two highly qualified, outstanding performers.

I would like to introduce our Executive Director, Lucretia Dewey Tanner, who is a valuable help to our committee, and to let you know that we don't have any plans to expand our efforts in the sense of added costs. Annually, this committee has been able to turn back some portion of our modest budget to the Treasury.

OBJECTIVES OF THE ADVISORY COMMITTEE

We have two major objectives, and those are to enhance the committee's effectiveness in the pay setting process and to improve the climate between the parties involved.

By that, I mean the administration and the worker represenatatives, whether they be management or union.

We have had considerable success, I believe, and have made strides in getting cooperation from the various parties we have asked for advice, and that includes Members of Congress and the administration, management representatives in Government, union representatives, members of the academic community, a person with prior experience in Government, the general public, and the media.

We are in the process of issuing a spring report, and we have sought counsel from all these groups, and we are receiving good cooperation.

We think it is worthy to note that in 1984 this committee with the deficit crisis in mind and nonetheless striving to be fair, departed from

past practice and did not recommend full implementation of the so-called comparability gap based on figures provided us by the Bureau of Labor Statistics. It was found that an 18.3-percent gap existed between Federal pay and private sector. We felt that this being unattainable, it was more reasonable to recommend something that would narrow the gap in a reasonable manner, and we recommended a 5.5-percent pay increase for Federal workers.

As you know, there was a 3.5-percent provision in the President's budget and Congress did not react adversely to that.

I wanted you to know the type of mindset that we have, and we are trying to be reasonable in our approach.

FISCAL YEAR 1986 BUDGET REQUEST

So far as our request of Congress this year is concerned, the Advisory Committee is asking for $219,000, or $1,000 less than our appropriation for the preceding fiscal year of 1985, and this is done in consideration of the guidelines that you have already stated to other witnesses.

Senator ABDNOR. How are you $1,000 less? Does that come out of numbers of people working? You have the smallest group, so you can't reduce your people by a very large number.

Mr. DUGGAN. No; we don't intend to do that, but we were asked along with other agencies, we have been reduced by 5 percent in anticipation of the 5-percent reduction in January 1985. Our funds cover salaries, travel expenses of staff, and committee members while they are engaged in active work, and we are not asking in the current budget any contingency funds for staff or any unanticipated problems or studies.

The studies undertaken are being done at no added cost to the Government. We are soliciting volunteer statements by experts in the field.

I would be happy to answer any other questions that you have, Mr. Chairman.

THE BLS SURVEY

Senator ABDNOR. The administration has failed to heed the committee's recommendation, not only this past year but for a long number of years. The 1984 report indicated, you said, 18.3 percent?

Mr. DUGGAN. Sir, I should explain that that was the finding of the Bureau of Labor Statistics, and the pay agent being made up of the Director of the Office of Management and Budget, the Director of Personnel Management, and the Secretary of Labor, passed these findings on to us.

Senator ABDNOR. That is a report from them?

Mr. DUGGAN. We don't quarrel with their findings, you understand, but we thought it realistic to recommend to the President a pay increase that we felt would be attainable, and this was based on the employment cost index which reflected the raises in private industry.

Senator ABDNOR. Well, we all know that the ink was hardly dry on that report before there were a lot of people who lambasted it and were very critical. OPM in particular has been critical.

Do they ever confer with the committee?

Mr. DUGGAN. Do they what, sir?

Senator ABDNOR. Do they confer with the committee?

Mr. DUGGAN. Absolutely. Let me say we have received excellent cooperation from OPM and the OMB. We have established a respectful relationship with all the parties involved.

To add to your concern, Senator, and I share it, of one of the problems confronting our committee, it is that conflicting studies produce contrasting figures on what the pay gap truly is. As you know, there was a House committee report just recently which produced figures that were considerably different from those of the Bureau of Labor Statistics. Our goal could certainly be made much more attainable if all the parties involved, and I am not excluding the public here in being the ultimate judge of fairness, were to agree on what the real figures are. We are working at it, sir.

Senator ABDNOR. I imagine that makes it quite difficult for you to come to some conclusions, right?

Mr. DUGGAN. It is difficult, but not unpleasant, yes, sir.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. I am sure you do a good job. I have other questions here. I think we will submit them for the record.

Mr. DUGGAN. We will be pleased to answer them.

Senator ABDNOR. I have to slip up to a military briefing. I don't want to rush anyone.

Mr. DUGGAN. Thank you, sir.

Senator ABDNOR. Thank you, Mr. Duggan.

Mr. DUGGAN. It was a pleasure for us, Mr. Chairman.

Senator ABDNOR. It was a pleasure to have you.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. Recent pay decisions certainly account for the current pay gap. The President is calling for a 5-percent reduction in Federal pay in fiscal year 1986. The President cites sacrifices in the private sector as one of the reasons for the reduction. Could you outline how this proposal fits with the current gap? What will it do to future pay actions?

Answer. The President's proposal to reduce pay by 5 percent for the 1.4 million white-collar and 450,000 blue-collar Federal workers is based on the severe deficit crisis facing the Nation. The administration believes that a one-time pay cut will not severely damage the Government's ability to attract and retain a competent work force.

According to the Bureau of Labor Statistics' study of private sector wages matched against 1984 Federal salaries, an 18.3-percent pay gap exists. Another study, one conducted by Hay/Huggins, indicates that Federal pay lags by 10.3 percent and, when benefits are considered, the lag drops to 7.2 percent. These studies have been criticized for not including small sized establishments, including too few occupations and, in the BLS study, not surveying State and local government employees. There needs to be agreement among all the parties involved that they will support a survey or method of adjusting pay for the future. Without such agreement, pay adjustments will continue to be based on no defined set of criteria.

Question. In light of the current attitude with regard to pay, do we have to rethink the process? What can we do? Would you like to comment?

Answer. When the President named me Chairman of this committee last May, I stated that there were two important objectives I would set out to achieve: (1) enhance the effectiveness of this committee in the pay-setting process and (2) improve the climate among all the groups involved in the pay-setting process, the President, Congress, and employee representatives. In issuing its report to the President last August, the committee stated that it would also issue a report in the spring of 1985. In preparation for this report, we have attempted to reach out to a broad cross section of groups and individuals in order to get their views and recommendations for improving the current process. Since we are still receiving responses, we would prefer not offering specific recommendations at this time but would like to make a copy of our report available to you after it has been delivered to the President.

Question. The committee recommended that future increases be based on the Bureau of Labor Statistics employment cost index [ECI]. How does this relate to the currently utilized system? What led you to this recommendation? Is it a realistic approach?

Answer. As I mentioned, a great deal of controversy surrounds the current BLS professional, administrative, technical, and clerical study. The pay agent agreed in its 1984 report that this survey should be expanded and the committee strongly endorsed this approach but recommended that, while this expansion was being undertaken, an orderly and systematic method for setting pay would be use of the BLS employment cost index. This ECI tracks labor cost trends for nearly 88 million workers in the nonfarm economy and covers a broad spectrum of white-collar jobs, industries, and firm sizes. In addition, its increase closely tracks that of the annual increases shown by the PATC survey.

We have not suggested that this ECI be used exclusively but that it be used on an interim basis while the PATC survey is expanded. In an ideal situation, the expanded PATC survey could be conducted every 3 years and, during the intervening 2 years, the ECI could be the basis for wage adjustments.

FEDERAL LABOR RELATIONS AUTHORITY

STATEMENT OF HENRY B. FRAZIER, III, ACTING CHAIRMAN

ACCOMPANIED BY:

WILLIAM J. McGINNIS, JR., MEMBER
JOHN C. MILLER, GENERAL COUNSEL
MARK A. AGLIO, COMPTROLLER
GEORGE B. BAILEY, JR., DIRECTOR, OFFICE OF FINANCIAL AND PROGRAM ANALYSIS, OFFICE OF THE GENERAL COUNSEL

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. Next is the testimony of the Federal Labor Relations Authority, Henry B. Frazier, III, Acting Chairman; Mr. John C. Miller, General Counsel, and you have a few others.

Mr. Chairman, I will ask you to proceed. Do you want to introduce all your colleagues. You have your nameplates. We appreciate that. That makes it easy.

Your whole statement will be made a part of the record. However you care to go, proceed. We will leave it up to you.

Mr. FRAZIER. Thank you, Mr. Chairman, very much. I do appreciate the opportunity to discuss with you today the fiscal year 1986 appropriations request of the Federal Labor Relations Authority.

As you can see from the nameplates, accompanying me here today are William J. McGinnis, Jr., who is a member of the FLRA, and Mr. John C. Miller, who is the General Counsel of the FLRA.

Also at the table are Mark Aglio, our Comptroller, and George Bailey, Jr., Director of the Office of Financial and Program Analysis in the General Counsel's Office.

PREPARED STATEMENT

I will submit for the record the written statement and, with your permission, I will briefly summarize it.

Senator ABDNOR. Fine.

[The statement follows:]

STATEMENT OF HENRY B. FRAZIER, III

Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss with you the FY 1986 appropriation request for the Federal Labor Relations Authority (FLRA). Accompanying me today are Mr. William J. McGinnis, Jr., Member of the FLRA and Mr. John C. Miller, General Counsel of the FLRA.

This appropriation request for $17,490,000 and 289 full-time permanent positions will provide adequate funding to achieve our FY 1986 program objectives. This request is an increase of $126,000 over the 1985 total of the Continuing Resolution level combined with the pending supplemental request to cover the January 1985 pay raise costs. The 289 full-time permanent positions is a 13-position reduction from current levels.

The FLRA budget request for $17,490,000 consists almost entirely of mandatory items of expenditure. Discretionary funding constitutes less than 10 percent of the request. As the table below indicates, salaries and benefits, space rental, and communications and utility charges constitute 91 percent of the FLRA appropriation request.

ITEM	PERCENT OF TOTAL BUDGET REQUEST
Personnel Compensation and Benefits	76%
Standard Level User Charges	11%
Communications, Utilities, and other Rents	4%
All Other Categories	9%
TOTAL BUDGET REQUEST	100%

Since so much of our funding request is for mandatory items, we cannot easily shift funds internally to meet unexpected expenses or any required reductions. Relatively small changes in funding levels can adversely affect accomplishment of our mission because the FLRA is a highly labor-intensive operation. This budget request has been carefully scrutinized and represents only those expenditure levels necessary to accomplish our FY 1986 program goals.

The FLRA was established to administer Title VII of the Civil Service Reform Act of 1978 and to serve as an adjudicatory agency in the resolution of labor-management disputes arising among unions, employees and Executive Department agencies (as well as some Legislative Branch agencies). The FLRA is also charged with resolution of labor-management disputes which may involve foreign national employees of the U.S. Government in the area of the Panama Canal, and our staff resources support the activities of the Foreign Service Labor Relations Board under Chapter 10 of the Foreign Service Act of 1980. There is a potential for labor-management disputes to arise in all these areas and the effective resolution of them by the Authority contributes to the efficient operations of the Government.

As you may know, a large backlog of cases developed in the Authority's early years of existence. High intake of cases and less than adequate resources combined to make the backlog seem insurmountable. However, FY 1984 was marked by a concentrated effort to reduce the backlog of cases at the Authority's National Office and we made significant progress. We did it by taking a number of initiatives including a reorganization to improve the management of case processing; several productivity improvement initiatives involving employee participation; and delegations of authorities and allocation of resources to better meet workload priorities. The result was a 40 percent increase in cases closed in FY 1984 compared to FY 1983 and a corresponding 16 percent reduction in case inventory or backlog. During FY 1984 we closed 750 cases, the highest number of cases closed, by over 100, since the inception of the FLRA.

While we managed to make major reductions in our case backlog in FY 1984, we recognize that we still have a great deal to do this year and in FY 1986 as well. At the beginning of FY 1985 we had 733 cases on hand and we project at the

beginning of FY 1986 that we will have 602 cases on hand. In the first quarter of FY 1985, the Authority closed 210 cases, the largest number of cases closed by the agency in any first quarter in its history. Our goal at the Authority is to continue to seek ways to expedite case processing and eliminate our backlog. We project that, if we can maintain our high rate of case production, by the end of FY 1986, the number of pending cases will be reduced by 38 percent from the number pending at the end of FY 1984.

With these objectives in mind, I would like to review our major program units: The Authority Members, the Office of Administrative Law Judges, Office of General Counsel, the Federal Service Impasses Panel, and management and administrative support.

The Authority Members program unit includes the Offices of the Members, the Offices of Chief Counsel and Case Management, and the functions of the Office of the Solicitor which relate to litigation and advice concerning case-decisionmaking activities. This program unit is directly responsible for the processing of all cases within the jurisdiction of the Members, from the receipt of case filings and related documents through the issuance of decisions resolving disputes over arbitration awards, negotiability determinations, unfair labor practices, and representation issues. It also includes all activities relating to judicial review or enforcement of Authority decisions. (The Statute grants the Authority the right to be represented by its own attorneys in any civil action brought in connection with any function carried out by the Authority.)

Cases involving exceptions to arbitration awards are projected to be a growing portion of our caseload. Such cases now make up about 20 percent of our pending cases; this percentage is expected to rise to about 32 percent as the number of new filings in this area increases. In order to deal with this increasing caseload, the Authority in FY 1984

instituted a task-force approach for review of these cases. This approach, which has proved successful for many arbitration cases, coupled with a procedure for identifying arbitration cases for expedited processing, should result in increased case production in this area through FY 1986.

Negotiability cases currently make up about 38 percent of our caseload and this percentage is expected to remain constant through FY 1986. We expect, however, to reduce significantly the number of pending cases in this area by the end of FY 1986 due to the allocation of an additional supervisory position and the disposition of lead cases having precedential value for other cases with similar issues. These cases are particularly difficult to expedite because they are presented by the parties to the Authority directly from the bargaining table and the Authority is the initial decisionmaker. Such cases commonly present a number of issues and many of these are ones of first impression. Even so, we believe we can improve timeliness of our case dispositions in this area.

Representation cases currently make up only about 4 percent of the Authority's caseload. In FY 1983 the Authority delegated to the Regional Directors, under the supervision of the General Counsel, the authority to resolve representation questions concerning determinations of appropriate bargaining units and certifications of exclusive representatives. Regional Directors' determinations on these cases are subject to review by the Authority Members on limited grounds only. As a result of this delegation, representation case intake has declined to a point where the Authority projects that there will be no backlog of pending cases in this area in FY 1985 and 1986.

Unfair labor practice cases are now about 38 percent of our caseload; this percentage is expected to decline to about 30 percent by the end of FY 1986. This projection is based on our assumption that intake will remain about the same but

productivity will improve. Specifically, we intend to push ahead with the ULP task force we instituted earlier this fiscal year.

In all case processing areas, we will continue to review and evaluate alternative case processing procedures in order to further improve our current system.

The Office of Administrative Law Judges is charged with the responsibility of holding hearings on unfair labor practice complaints issued by the General Counsel and for recommending decisions to the Authority. It is projected that the number of ALJ settlements and decisions per Judge will increase by approximately 6 percent from FY 1985 to FY 1986 as a result of increased productivity and more effective scheduling of hearings.

The Office of the General Counsel has final authority over the investigation of charges and the issuance and prosecution of all ULP complaints. The Office also investigates and makes the initial disposition on representation petitions; supervises or conducts representation elections and certifies the results to the parties; and conducts hearings in representation cases. In addition, the General Counsel directs and supervises the activities of employees in the Regional Offices. General Counsel Miller, in his prepared statement, will address the program and the budgetary aspects of the General Counsel's operation in FY 1986.

The Federal Service Impasses Panel is an entity within the FLRA which is responsible for assisting Federal agencies and unions representing Federal employees in resolving impasses arising out of labor negotiations. It is composed of Chairman Roy M. Brewer of California and Members H. Victor Goodman of Ohio, Robert G. Howlett of Michigan, Daniel H. Kruger of Michigan, and Susan S. Robfogel of New York. All are Presidential appointees and serve on the Panel on a part-time basis. The Panel serves as the Federal sector substitute for

the strike/lockout. As a result, it is most important for the Panel to have adequate resources available to deal with critical impasses. It should be noted that the workload of the Panel, like that of the Authority, is uncontrollable. If the mediation efforts of the Federal Mediation and Conciliation Service (FMCS) prove unsuccessful, the Panel will then assist the parties, as required, in resolving the impasse. Resolution techniques utilized by the Panel include informal conferences, factfinding and interest arbitration. The Panel emphasizes voluntary settlement, believing that agreements which are reached by the parties themselves enhance commitments to contract terms. When an impasse is referred to the Panel, it expeditiously initiates its proceedings and it has set specific objectives for timeliness. In FY 1986, the Panel will seek to complete the investigation of negotiation impasses within 21 days after receipt. Within 40 days, the Panel will either recommend procedures for impasse resolution or offer direct assistance in compliance with statutory requirements. It is the goal of the Panel to close all cases within a median timeframe of 95 days. Those cases which require final action such as a Decision and Order will be closed within a median time of 110 days. It is projected that in FY 1986 the Panel will resolve approximately 180 impasses. This represents an increase of slightly over 11 percent from actual levels in FY 1984. The Panel hopes to handle the increase entirely through productivity improvements. The Panel is dedicated to furthering the principles of collective bargaining in the Federal sector and will continue to emphasize voluntary dispute resolution.

The management and administrative support function provides agency-wide support services to the National and Regional Offices. The Offices of the Executive Director/Administrator, Solicitor, Comptroller, and Personnel are responsible for a full range of legal, budget, financial, personnel and

administrative support services. Of course, accomplishment of our mission depends to a great extent on the effective performance of these support functions.

In summary, I am pleased to report that the FLRA is making progress in improving the timeliness and responsiveness of its case processing. We will continue to make every effort to reduce the time required for case processing and we remain dedicated to reducing the number of pending cases.

Our budget is based entirely on these objectives. Your approval of the requested resource levels will allow us to continue to fulfill our Congressionally mandated mission. To that end, we request your approval of $17,490,000 for the FLRA in FY 1986.

Mr. Chairman, this concludes my prepared remarks. I will be glad to answer any questions you and the members of your Committee may have after General Counsel Miller has presented his statement.

BIOGRAPHY OF HENRY B. FRAZIER, III

Henry B. Frazier III of Alexandria, Virginia, has served as a Member of the Federal Labor Relations Authority since January 1979. He was designated Acting Chairman by President Reagan on September 1, 1984. The Authority is an independent agency in the Executive Branch and administers the Federal Service Labor-Management Relations Statute which governs labor relations between managers of Federal agencies and unions representing Federal employees. The Authority is responsible for adjudicating representation and unfair labor practice cases, negotiability disputes and exceptions to arbitration awards.

Prior to his appointment to the Authority, Frazier was with the Federal Labor Relations Council (the predecessor agency of the Authority) for 9 years, serving the last 6 of those years as its Executive Director. Previously he had served as Deputy Executive Director and as Chief of the Program Division. While serving as Executive Director of the Council, he received a Special Citation for Exceptional Performance from the Director of the Office of Management and Budget, the Chairman of the Civil Service Commission and the Secretary of Labor. Before joining the Council, Frazier had spent 11 years in personnel administration with the Department of the Army, serving in both operating organizations in the field and in staff organizations in the Pentagon. His last position with Army, immediately prior to joining the Council, was Chief of Civilian Personnel Policy and Civil Rights in the Office of the Assistant Secretary for Manpower. While with Army he received from the Secretary of the Army the Exceptional Civilian Service Award--the Department's highest award for civilian personnel--and the first annual W. H. Kushnick Award for

Outstanding Achievement in Personnel Administration in the Department.

Frazier is an attorney and has a J.D. with Honors from George Washington University Law School and an LL.M. in Labor Law from Georgetown University Graduate Law Center. Frazier received a B.A. with Honors in Political Science from the University of Virginia and is National Vice President and a member of the National Board of Managers of the University of Virginia Alumni Association. He is a member of Phi Beta Kappa, the Order of the Coif, the Virginia Bar, the Bar of the District of Columbia and the Bar of the Supreme Court of the United States. He is an Air Force veteran.

BIOGRAPHY OF WILLIAM J. MCGINNIS, JR.

William J. McGinnis, Jr. of Brant Beach, New Jersey and Venice, Florida was recess appointed as a member of the Federal Labor Relations Authority on December 14, 1984 by President Ronald Reagan. He is currently serving in a term which expires July 1, 1989 pending Senate confirmation.

The Authority is an independent agency in the executive branch which administers the Federal Service Labor - Management Relations Statute which governs labor relations between managers of federal agencies and unions representing federal employees. The Authority is responsible for adjudicating representation in unfair labor practice cases, negotiability disputes and appeals from arbitration awards. Prior to his appointment to the Authority, McGinnis was the Chief Executive Officer of William J. McGinnis and Associates, a management consulting firm. He also served for two consecutive terms as a Commissioner in the Long Beach Township, New Jersey municipal government. He was responsible for personnel administration, public safety, public works and buildings and grounds functions.

Previously Mr. McGinnis served as Vice Chairman of the Presidential Advisory Council on Vocational Education from December 1982 until December 1984. He served as the Chairperson of the Joint Task Force which resulted in the publication of the nationally acclaimed report "A Nation at Work." Mr. McGinnis was an elected delegate to Local 1776 American Federation of Teachers - AFL-CIO while he was on the faculty of Bishop Egan High School in Fairless Hills, Pennsylvania.

Mr. McGinnis received a Bachelor of Science degree in Business Administration from LaSalle College, in Philadelphia, Pennsylvania. He received the Equal Employment Opportunity Compliance and Administration certificate from Rutgers, the State University in New Brunswick, New Jersey and a Master of Science In Industrial Relations/Human Resources, from Rutgers, the State University. He is a member of the Panels of the American Arbitration Association and he is also a member of the Industrial Relations Research Association, the Society of Government Economists, ASPA, ASTD, and IPMA.

BUDGET REQUEST

Mr. FRAZIER. Our appropriation request is for $17,490,000, and 289 full-time permanent positions. We believe this will provide us with adequate resources to meet our program objectives in fiscal year 1986. It is, as noted earlier today, an increase of some $126,000 over fiscal year 1985.

The number of positions being requested, 289, is a 13-position reduction from our current levels.

I would like to emphasize that over 90 percent of the appropriation we are requesting is for mandatory items. By that, I mean salary and benefits, space rental charges, communications charges, and utility charges, so that less than 10 percent of our budget is for discretionary spending.

Senator ABDNOR. I see.

Mr. FRAZIER. I think the key point is that since so much of our funding is for mandatory items, we don't have a great deal of flexibility to shift funds internally to meet unexpected expenses or required reductions. We are a small, labor-intensive organization, so a change in funding is likely to have an impact on personnel and an ability to accomplish our mission.

The budget request was carefully scrutinized and it represents only that which we believe is needed to accomplish the program goals outlined in the budget.

Congress established the Federal Labor Relations Authority to resolve labor disputes in the Federal sector. We also have responsibilities in the Panama Canal area, and our staff provides staff support to a comparable body that resolves disputes in the Foreign Service of the United States.

So when we do our job effectively, we believe we contribute to the efficient operations of the Government.

In the early years of our existence, a large backlog of cases developed at the Authority, and we have been working very diligently in recent years to reduce the number of cases pending before the Authority.

In fiscal year 1984, for example, a concentrated effort was made to cut into the backlog, and I am happy to report significant progress. Management initiatives resulted in a 40-percent increase in cases closed in fiscal year 1984, as compared to fiscal year 1983. We had a corresponding 16-percent reduction in case inventory on hand. In that year, we closed 750 cases, which were more than 100 over the largest number in any preceding year.

We recognize we still have a great deal to do this year and in fiscal year 1986. We have started fiscal year 1985 with our best first quarter ever, and we have set ambitious goals for the remainder of this year and for fiscal year 1986 so that we hope by the end of fiscal year 1986 we will have reduced by 38 percent the number of cases that we had on hand at the beginning of this year.

We are continuing to search for ways to improve case processing. We have attacked problems as we perceived them, and we have attempted

to streamline our operations, and I have set out the measures that we have taken in the written statement.

Senator ABDNOR. Can you pretty well estimate what is going to happen, I mean in numbers?

Mr. FRAZIER. We think based on past history and what we project to be the number of cases filed in fiscal year 1986 along with what we project to be our levels of productivity approximately how many cases we will have received and closed and have on hand at the end of the year, and we have that in our budget statement.

Always bear in mind that we have no control ove our caseloads. People can walk in and file a case, and we can't say no. We have to take it and process it and do something with it. We are at the whim and will of the parties.

Senator ABDNOR. Very good.

Mr. FRAZIER. General Counsel Miller will address the program aspects of the General Counsel's Office. Mr. Brewer, who is chairman of the Federal service impasses panel, was unable to be here today. I have covered the panel's activities in my statement.

The panel serves in the Federal sector as the substitute for the strike or the lockout, and so that this function is very critical to the effective operations of Government, and to the smooth operations of the Labor-Management Relations Program.

To wrap up, I think we are making progress in timeliness and responsiveness at the agency, and we are dedicated to reducing the time taken in processing cases and the number of cases on hand. Our budget is based on the objectives outlined.

We would request respectfully your committee's approval of our proposed resource levels.

This concludes my remarks. I will be happy to answer any questions after General Counsel Miller has made his statement.

Senator ABDNOR. I will be right back. I have to go vote. Mr. Parkinson will continue.

OFFICE OF THE GENERAL COUNSEL

Mr. PARKINSON. John, do you want to proceed and present your statement?

PREPARED STATEMENT

Mr. MILLER. Thank you. I will proceed.

Again, I assume my entire statement will be in the record.

Mr. PARKINSON. That's correct.

[The statement follows:]

STATEMENT OF JOHN C. MILLER

As the General Counsel of the Federal Labor Relations Authority, I appreciate the opportunity to appear before you to present the budget request for the Office of the General Counsel for Fiscal Year 1986 and to support the total budget request for the Agency. We have already submitted a detailed written budget justification in support of our request. With your permission I should like to touch briefly on some of the highlights of that justification and make a few observations as well.

The budget request for the Office of the General Counsel, hereafter referred to as the General Counsel, totals $7,848,000 for Fiscal Year 1986, excluding centrally funded items and provides for 152 full-time permanent positions. Although this request includes a reduction of 13 full-time permanent positions, or 15 full-time equivalent workyears, from our approved level for Fiscal Year 1985, we fully expect to maintain manageable caseloads as will be discussed more in detail hereafter. In any event, I fully support the President's initiative to reduce the level of government spending and I will continue to monitor our expenditures to insure the efficient utilization of the resources allocated to us.

Of the total budget request for the General Counsel, 86 percent is required to cover the costs of personnel compensation and benefits. A total of $575,000 is programmed for travel. The costs of court reporting services are estimated at $120,000. Equipment rental costs for the National Office and all of our Regional Offices are now estimated at $89,000. The costs of supplies and library subscriptions for our Regions is estimated at $103,000. The remaining three percent of our budget, $229,000, is set aside for equipment repair contracts, employee training costs, printing and reproduction cost, and other miscellaneous costs. My point in testifying in such detail is to stress the initiatives we have already taken to reduce our funding level to the minimum.

For example, from our request last year, we have reduced funding for travel by $75,000 or 11.5 percent; the request for supplies and reusable materials

has been reduced by 19 percent; expenditures for rental equipment have been reduced by some 49 percent; lastly, we have reduced substantially our projected costs for court reporting services.

Before reviewing the impact of this budget on our program, I would like to briefly outline the responsibilities of the Office of the General Counsel. As an independent component of the Federal Labor Relations Authority, the General Counsel is directly responsible for investigating all alleged unfair labor practices filed pursuant to the Federal Service Labor-Management Relations Statute, the Panama Canal Act and the foreign service labor-management relations provisions of the Foreign Service Act. Moreover, the General Counsel has direct authority and responsibility for the issuance of complaints resulting from the unfair labor practice charges filed pursuant to the aforementioned Statutes. The General Counsel also has responsibility for the investigation and disposition of representation case petitions, the conduct of all representation case hearings, the supervision of all representation elections and the certification of the results of such elections by virtue of the Authority's delegation of these responsibilities to the Regional Directors of the Authority who fall under the direct supervision of the General Counsel. Moreover, at the beginning of Fiscal Year 1984, the Regional Directors became responsible for the preparation and issuance of Decisions and Orders in representation cases pursuant to the Authority's delegation of this function. The Decisions and Orders are, of course, subject to appeal to the Authority. Finally, as alluded to above, the General Counsel is responsible for the supervision and management of the Authority's Regional Offices.

Experience in both private and public employment indicates that the statutory right of employees to organize, to bargain collectively through representatives of their own choosing and to participate in decisions which affect them, safeguards the public interest and contributes to the effective conduct of public business. These statutory protections also facilitate and encourage the amicable settlement of disputes between employees and their employers involving conditions of employment. The Federal Service Labor-

Management Relations Statute details certain rights and obligations of the employees of the Federal Government and establishes procedures which are designed to meet the special requirements and needs of the Government to be efficient and effective. The General Counsel operates in the Federal Sector labor-management relations arena to ensure compliance with the statutory rights and the obligations of Federal employees, labor organizations which represent those employees and the Federal Agencies falling under the jurisdiction of Title VII of the Civil Service Reform Act of 1978.

With these thoughts in mind, I should like to express some of my specific observations regarding this budget request. A key element in the request is the reduction of 15 full-time equivalent workyears in the Office of the General Counsel. The processing timeframes projected in the request were those which were achieved at the end of Fiscal Year 1982 with more positions. Under current conditions, 61 percent of all unfair labor practice charges filed are those determined to have no merit. Should this reduction in staff be accompanied by any increase in merit caseload, a substantial lengthening of case-processing timeframes may result. To prevent this, I have initiated actions to intensify our efforts to work with the parties involved to reduce the filing of charges lacking merit and I expect to make further progress administratively, through the use of specific criteria, for example, to discourage such filings. I cannot, however, under present statutory authority, absolutely preclude such filings. Nevertheless, because of my optimism as to the success of our ongoing efforts, I project only a slight increase in our intake from Fiscal Year 1985 to Fiscal Year 1986. I must, however, stress that these are estimates only and that the Office of the General Counsel has no control over the size of its intake. Last year, for example, although we projected case filings to increase, they actually declined by 3 percent for Fiscal Year 1984.

In Fiscal Year 1986 I will continue to assign the highest priority to the processing of representation cases, including the expeditious handling of petitions, conducting hearings and elections and issuing decisions following those hearings. This budget request provides the necessary resources for

the timely processing of this priority workload--a median time of 75 days from receipt of a representation petition to its disposition, approximately two (2) weeks above our current factor; roughly 30 days to hearing or election from the appropriate notice, in line with our current factor; and about 60 days from close of the hearing to decision, also in line with our current factor.

I should like to present a brief look at the current case flow of the Office of the General Counsel and focus on the principal challenges in processing the caseload. When an unfair labor practice charge is filed, it is investigated and, if found to be meritorious, the parties are encouraged to settle voluntarily without further action. Nearly two-thirds of all charges found to have merit are settled prior to the issuance of complaint. If settlement cannot be obtained, however, a complaint will issue, although settlement efforts continue and are strongly encouraged. Approximately 70 percent of all complaints are settled prior to hearing. Where settlement cannot be obtained prior to hearing, the complaints are prosecuted by the legal staff of the General Counsel in a hearing before an administrative law judge. Only about 10 percent of all merit charges (roughly four percent of all charges received in the Regions) make it to the adjudicatory level, i.e., to the Authority.

Cases found to be without merit are either voluntarily withdrawn or are dismissed. It is projected that 55 percent of all cases determined to be without merit will be withdrawn. The remaining 45 percent will be dismissed and of that number approximately 35 percent will be appealed to the General Counsel. I anticipate that roughly one (1) non-merit case in six (6) will be appealed which equates to slightly less than one appeal for every ten charges received. This factor is lower than the factor projected in last year's budget.

Outlined below is a summary of the outcome of a percentage sample of 100 unfair labor practice charges, using actual experience from Fiscal Year 1984. The Table summarizes all of the initial and secondary actions taken.

Merit Cases 39

Pre-Complaint Settlements .....(26)

Complaints .....(13)

(Post-Complaint Settlements) .....(9)

(Hearings/Stipulations) .....(4)

(Violations Found) .....(3)

(No Violations Found) .....(1)

Non-Merit Cases 61

Withdrawals .....(33)

Dismissals .....(28)

(No Appeal Filed) .....(18)

(Appeals) .....(10)

(Region Sustained) .....(9)

(Region Reversed) .....(1)

(Violation Found) .....(1)

In summary, with a total settlement rate of approximately 90 percent, only about four out of every 100 charges will reach the Authority for disposition.

Briefly, I would like to review our accomplishments in Fiscal Year 1984.

-- During the year 5,583 cases were received. Included in this total were 5,179 unfair labor practice charges and 404 representation petitions.

-- A total of 5,590 dispositive actions were taken, keeping pace with intake. Of these, roughly two-thirds were taken within 75 days of receipt of the charge. Only six percent of all charges filed required more than four months to disposition from receipt of the charge.

-- Only 981 cases were pending without dispositive action at the end of the year, slightly below the total carried into the year.

-- The General Counsel, through its regional operations, conducted 108 elections in Fiscal Year 1984. Elections were held in two petitions for unit consolidation, in six petitions for decertification and in 100 petitions for exclusive recognition. In the six decertification petitions, 78.5 percent of all eligible voters cast ballots. In the 100 petitions for exclusive recognition, out of 20,453 eligible employees, 12,809 ballots were cast (62.5 percent). In 93 of the 100 elections, an exclusive representative was certified while in the remaining seven no representative was certified.

-- A total of 802 complaints had disposition, essentially equal to the total for the previous fiscal year. Included in this total were 580 which were voluntarily settled. Hearings were held before administrative law judges in 163 cases.

-- Timeliness factors continued to improve through the Fiscal Year. The median age for dispositive action in unfair labor practice cases was 66 days, eight days below that factor for the previous year. The median age factor for unfair labor practice complaints, measured from date of issuance to scheduled hearing was 54 days, also eight days below the comparable factor for Fiscal Year 1983. The median age for appeals in unfair labor practice cases, measured from the receipt of the appeal to disposition, was reduced by 29 days to a level of 62 days. Finally, the median age for representation cases, date of filing to disposition, was reduced by 3.5 days in Fiscal Year 1984 to a level of 53.5 days. I am extremely proud of our Fiscal Year 1984 performance in all areas.

-- Conclusion --

This concludes my formal statement in support of the President's budget request for the Office of the General Counsel for Fiscal Year 1986. With the continued support and assistance which this Subcommittee has provided in the past, I pledge that my staff and I will continue to strive to meet our

responsibilities and the challenges with renewed spirit. Thank you for your attention. I will be happy to respond to any questions which you may have.

Biography of John C. Miller

John C. Miller was sworn in as General Counsel of the Federal Labor Relations Authority on March 8, 1983.

From December 1982 through March 7, 1983 Mr. Miller served as Chairman of the National Labor Relations Board. During the period of 1981 - 1982 he served as Chief Counsel to the Chairman of the National Labor Relations Board. From 1977 - 1981, Mr. Miller was an Administrative Law Judge with the NLRB. During the period of 1972 - 1977, he served as Solicitor of the NLRB and during that period also served for 3½ months as Acting General Counsel.

From 1971 through 1972, Mr. Miller was the Minority Counsel to the House Education and Labor Committee. The ranking minority Congressman was Albert Quie of Minnesota and the second ranking minority Congressman was John Ashbrook of Ohio.

From 1963 through 1971 Mr. Miller served as a Supervisory Attorney on the staff of Member Howard Jenkins of the National Labor Relations Board. His duties required the supervising of up to six attorneys, the regular attendance at meetings representing Board Member Jenkins, the making of initial determinations on pending cases and analyzing and recommending disposition of cases.

During the period of 1959 through 1963, Mr. Miller served on the staffs of National Labor Relations Board Members Rogers and Leedom.

From 1958 - 1959, Mr. Miller was an attorney in the Office of Appeals in the Office of the General Counsel of the National Labor Relations Board. In this capacity he reviewed and recommended disposition of cases on appeal from a Regional Director's refusal to issue a complaint on an unfair labor practice charge.

Mr. Miller was employed as an attorney with the Labor Relations and Legal Department of the Chamber of Commerce of the United States from 1955 through 1958.

Mr. Miller is a resident of Rockville, Maryland. He graduated from Bowling Green State University, Bowling Green, Ohio in 1950. He also holds an LLB and LLM degrees from Georgetown University Law School. These degrees were awarded in 1955 and 1957, respectively. Mr. Miller is the author of a Federal Bar Journal article (April - June issue 1958) entitled "Conflicts in Circuit Courts Over Enforcement of Arbitration Awards" and the author of a pamphlet entitled "Extortion" an analysis of laws governing political contributions by labor organizations and corporations. Mr. Miller is a member of the bars of the District of Columbia and the State of Ohio and is admitted to practice before the Supreme Court of the United States.

EXPLANATION OF GENERAL COUNSEL BUDGET

Mr. MILLER. The budget request for the Office of the General Counsel totals $7,848,000 for fiscal year 1986. Now, this excludes centrally funded items and provides for 152 full-time positions.

I would like to point out that, similar to the Authority, 86 percent of our budget request covers personnel compensation and benefits. We have $575,000 for travel, cost of court reporting services about $120,000, and miscellaneous services 3 percent, or about $229,000.

I would also like to point out that from our request last year we have reduced funding for travel by $75,000, or 11.5 percent. Requests for supplies of reusable materials has been reduced by 19 percent, expenditures for rental equipment have been reduced by some 49 percent, and last we have reduced our projected costs for court reporting services.

The latter we can't take too much credit for. We haven't had as many hearings as in prior years.

DELEGATION OF AUTHORITY

Going to page 3 of the statement, I would like to point out that since the beginning of fiscal year 1984, the regional directors have now become responsible for the preparation and issuance of decisions and orders in representation cases. This was pursuant to a delegation by the Authority whereby the regional directors issued an initial decision and order, which can be appealed to the Authority.

Moving on, I won't go into anything about the functioning of the General Counsel's Office, which is normally routine, and is similar to what we did last year. We simply handled two types of cases, representation cases and unfair labor practice cases.

Moving on, I would like to just comment briefly on some of our accomplishments in fiscal year 1984. We disposed of about as many cases as we took in, so we are happy with that. We didn't increase our backlog any.

At the end of the year, 981 cases were pending without dispositive action, slightly below that of the prior year.

We have continued to do most of our work in a timely fashion. For example, the median age for dispositive action and in unfair labor practices was 66 days, 8 days below the same factor for the previous year.

The median age measured from the date of issuance of complaint to the scheduled hearing was 54 days, also 8 days lower. The median age for appeals in unfair labor practice cases measured from receipt of appeal to disposition was reduced by 29 days.

And, finally, the median age for representation cases was reduced by 3.5 days to 53.5. I wanted to point out that we are extremely proud of the operations of our regional offices.

I am taking the credit, but the work was really done by our regional directors and the fine staff we have in nine regional offices and three subregional offices.

I think the rest of the statement, including some tables, will be simply part of the record.

Mr. PARKINSON. Thank you, Mr. Miller. I think we will proceed with questions that were prepared. I believe the Senator will be back right away after the vote, but we will proceed along that point because of the fact that he has another committee meeting that is supposed to begin at 2 o'clock. We will do this to expedite things.

BUDGET INCREASES

In the budget justification and from the statements, over all there is going to be—you are seeking an increase of $31,000 of travel and transportation over last year's request. How are the additional funds for travel going to be used, and what is the justification for the increase?

Mr. FRAZIER. Do you wish to comment?

Mr. MILLER. The increase is not for the Office of the General Counsel. I think Mark can answer that.

Mr. AGLIO. The increase will come on the Authority side and at the Federal service impasses panel. Approximately $6,000 will be for mandatory costs associated with FSIP Program travel, with the remainder spread throughout the various components in the Authority.

It should be noted that during fiscal year 1985, the agency at the members' level has a vacancy. As a result less than the normal level of travel has been performed by the Authority members.

A portion of this increase will be allocated for travel at the Authority member level in fiscal year 1986 with the remainder being associated in projected cost increases within the Authority.

Mr. PARKINSON. It is to be noted in the statement that you are seeking an increase of $126,000 over last year's funding level. But I also see that you are cutting your current ceiling by 13 permanent positions. Could you explain briefly your justification for additional funds in light of your staffing reductions?

Mr. FRAZIER. Yes; I think I can answer that question.

The change, the increase of $126,000, results from some increases and decreases in several categories.

For example, in the category of personnel costs, we have an increase of $91,000. This amounts—and that is a net increase—it amounts to a gross increase of $716,000, and then a reduction which is offset by the 13-position reduction of $474,000, and other salary adjustments of $151,000.

In essence, the increase will pay for periodic step and merit pay increases, and provide full-year funding for the pay increase which was effective on January 6, 1985.

Then we have an increase, as noted, in the costs of travel and transportation. We have increased costs in the Federal telecommunications system, FTS, and in commercial telephone costs of $19,000. We have increased printing costs of $11,000, increased costs for maintenance of equipment, court reporting, and miscellaneous services of $55,000, and then we have reductions in our SLUC charges of $58,000.

These are paid, of course, to GSA, and this represents office space that was turned back.

Mr. PARKINSON. That was what I was going to ask next. Are you proceeding along under the 135-square-foot provision?

Mr. FRAZIER. We have in the first year of the program initiative met the 10 percent and exceeded the 10-percent goal for the first year. We are presently in the throes of dealing with the General Services Administration over a possible relocation of the headquarters of the agency here in Washington. We have been informed that the Federal Emergency Management Agency requires the remainder of the space in our building. We are housed in a commercial building with FEMA, and we have been advised that they need the space we are in, and, therefore, we have been informed by GSA that we will be required to move from that headquarters space to other space somewhere in the Washington area.

Mr. PARKINSON. Those meetings are basically discussions at this time?

Mr. FRAZIER. We have been told we are going to have to move, and GSA is now making determinations as to how much space we require, whether that space is available in their inventory in the Washington area, whether it isn't, whether they will have to come to Congress to seek approval of a prospectus for new space for the agency. We are starting down that long road right now.

Mr. PARKINSON. Good luck.

Mr. FRAZIER. Thank you.

The final item was the $21,000 reduction in the number of pieces of equipment projected to be replaced in fiscal year 1986. All those plusses and minuses amount to a $126,000 increase for this year.

PERMANENT POSITION REDUCTION

Mr. PARKINSON. The budget submission calls for reduction of 13 positions at the Authority, all of which are to come out of the Office of General Counsel.

How was this determination reached, and what impact will it have on General Counsel's operations?

Mr. FRAZIER. Mr. Miller, do you wish to address that?

Mr. MILLER. I will address the impact if you will address the first part, the decision.

Mr. FRAZIER. The decision was reached in a passback which we received from OMB.

Mr. PARKINSON. Was that passback appealed?

Mr. FRAZIER. Yes; it was.

Mr. MILLER. As far as the impact question, a reduction of that size is, of course, approximately 9 percent on the General Counsel's staff. It was more than we had expected, but we do think that we can continue to timely process our representation cases.

In the unfair labor practices area, we are hoping that—we expect to be able to manage our caseload, but there may be some lengthening of timeframes in order to do that. It depends to a great extent, as the chairman has already pointed out, on how much case intake we have. If our case intake is about what we project, 7 percent or so, we should be able to manage it without abnormal backlogs building up.

But, again, as I say, we have no real control over our intake, and we are also initiating some programs trying to deal with what OMB has addressed as nonmeritorious unfair labor practice charges.

The difficulty we have is, of course, weeding out as fast as possible what is meritorious and not meritorious, and obviously the case that can be dismissed or withdrawn almost with little investigation costs us very little. I think the costs of our case handling, if they go straight on through to the Authority, are about $3,000 a case.

Mr. BAILY. That's correct.

Mr. MILLER. An average cost, that is. First of all, as my statement states, we have what you call a 100-charge vignette, which shows us what happens to 100 charges. Of those 100, we find 39 have merit. We settle over 90 percent, or about 35 of those, and 4 will get to the Authority either by way of stipulation or hearing.

Now, again, and perhaps I am lengthening the response, but all I can say is that we hope we can effectively manage the caseloads and we are going to make an attempt to do so.

Mr. PARKINSON. In order to reach the reduction, will a RIF be necessary, or will attrition take care of the reduction?

Mr. MILLER. I am hopeful, and I think the scope of the administration's program was, to do it by attrition. We are hopeful we can do it by attrition. I am not sure. We will take a look at it at the 6-month period at the end of March.

Unfortunately, we had large attrition last year, but this year we seem to have fallen off. I think the tendency is when budgets get tight everywhere, hiring decreases and people are less likely to move from one agency to another.

We are hopeful we can achieve that goal by attrition, and we will have a better idea by March. Today, I think we have had two or three terminations from the date of the passback from OMB in December. It may be too early to judge, but we are hoping we can do it by attrition.

Mr. PARKINSON. All the members of the Authority have not yet been confirmed by the Senate. Is this causing a problem in your caseload, or is it causing any problems as far as the running of the Authority?

Mr. FRAZIER. In terms of the administrative management of the Authority, Congress amended our statute, as you probably recall, about 1 year ago, and made the chairman the chief executive officer. So in terms of the day-to-day administrative management of the agency, there is no problem.

In terms of caseload, Mr. McGinnis is on board as a recess appointee, and is able to work on cases and decide cases in that capacity, and while there are only two of us, it would always be nice to have the third person around to have the views of the third person.

We are able to get cases out. Mr. McGinnis, do you have anything to add to that?

Mr. MCGINNIS. I think obviously the conflict arises where the current members cannot agree, and that type of case must be put aside, if enough such conflicts arise there——

I think that the appointment, the rapid appointment, and confirmation of three members of the panel will contribute to elimination of the backlog because when two of the members can't concur, if you have a lot of differences between the members, which obviously occur when we deal with the numerous subjects we have before us, that obviously can create a backlog problem.

Mr. PARKINSON. Do we have any indication, just for our interests here, how long it is going to be before you will be up to full membership?

Mr. FRAZIER. I have no indication.

Mr. MCGINNIS. None whatsoever.

Mr. PARKINSON. We will have to keep an eye on that. We do talk with the White House from time to time. We will do our best on that.

We may have a few other questions for the record. I want to thank you on behalf of the subcommittee and Senator Abdnor for participating today, and we look forward to hearing from you in the coming budget year.

Mr. FRAZIER. Thank you very much.

Mr. MCGINNIS. Thank you.

COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

STATEMENT OF MAJ. GEN. JOSEPH H. CONNOLLY, CHAIRMAN

ACCOMPANIED BY CHARLES W. FLETCHER, EXECUTIVE DIRECTOR

PREPARED STATEMENT

Mr. PARKINSON. Our final witness today will be Maj. Gen. Joseph Connolly, the Chairman of the Committee for Purchase from the Blind and Other Severely Handicapped. Welcome, General. I guess we will proceed awaiting Senator Abdnor's return.

I would like to note for the record that this is the General's first appearance before us, also, and we welcome you. Your entire statement will be made part of the record, and please proceed as you wish.

[The statement follows:]

STATEMENT OF MAJ. GEN. JOSEPH H. CONNOLLY

Mr. Chairman, we are pleased to appear here today to present the appropriations request of the Committee for Purchase from the Blind and Other Severely Handicapped for fiscal year 1986.

This committee was created by the Javits-Wagner-O'Day Act (Public Law 92-28) in 1971. The committee is the successor to the Committee on Purchases of Blind-Made Products established by the Wagner-O'Day Act of 1938. Its purpose is to increase employment opportunities for blind and other severely handicapped, and whenever possible, to prepare these individuals to engage in normal competitive employment. The committee's primary means for achieving its objective is to direct the Government's procurement of selected commodities and services to qualified workshops serving the blind and other severely handicapped.

The 15 members on the committee are appointed by the President. Eleven members represent various Government agencies and four are private citizens who are conversant with the problems of employing blind and other severely handicapped persons.

Under the act, the committee has the responsibility for determining which products and services the Federal Government buys are suitable for provision by qualified workshops serving the blind and other severely handicapped. The committee establishes the prices which the Government must pay for those commodities and services.

The committee has a full-time staff of 12 persons to assist in the implementation of the program. The staff is responsible for developing recommendations and proposals for the consideration of the committee. Operationally, it supervises the selection and assignment of new commodities and services; assists in establishing the fair market price and reviewing price changes; verifies the qualifications and monitors the performance of workshops; and services as a vital link between the workshops and the Federal Government in expanding the program and resolving production problems. In addition, the staff handles all of the administrative functions for the committee such as developing policies and procedures, initiating and responding to correspondence, preparing the committee's budget, and performing all the functions required of an independent Government agency.

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During fiscal year 1984, the committee continued its progress in expanding the benefits of the Javit's-Wagner-O'Day Act to increasing numbers of blind and other severely handicapped individuals.

Workshop sales to the Federal Government under the committee's program during fiscal year 1984 were $235 million. In addition, sales through the Military Resale Program were $15 million, for a total of over $250 million under this program. This represents an increase of $36 million over the total workshop sales of $214 million in fiscal year 1983.

Blind workshop sales, including those through the Military Resale Program, increased from $138 million in fiscal year 1983 to over $165 million in the past year.

Government sales by other severely handicapped workshops under this program were $85 million, an increase of $19 million over fiscal year 1983.

During the past year, the committee approved the addition of 48 commodities and 60 services to the procurement list with a total annual value of $27 million. These additions created new jobs for nearly 800 blind and other severely handicapped individuals.

As of September 30, 1984, there were 290 blind and other severely handicapped workshops authorized to produce products or provide services for the Federal Government under the committee's program, an increase of 18 over the year before. This trend is expected to continue in fiscal years 1985 and 1986 with a commensurate increase in the workload of the committee staff.

The committee staff made 110 visits to workshops in fiscal year 1984 to ensure their compliance with the act and the committee's regulations and to resolve production problems in producing commodities or providing services under the act. We are planning about 150 staff visits to workshops in each of fiscal years 1985 and 1986.

The committee's appropriation for fiscal year 1985 was $710,000. We plan to absorb within our fiscal year 1985 appropriation of $710,000 the increases in pay in fiscal year 1985 of about $12,000 due mainly to the Federal pay raise which went into effect on January 6, 1985.

Our appropriation request for fiscal year 1986 is for $730,000. This is an increase of $20,000 over the appropriation for fiscal year 1985. The largest increases are in the pay for full-time personnel and in other services. In the latter account we are forecasting increased costs in fiscal year 1986 for legal support from GSA and for computer programming.

In my view the committee's budget request for fiscal year 1986 represents the minimum funds required for it in carrying out its responsibilities in expanding employment opportunities for the Nation's blind and other severely handicapped.

BUDGET SUMMARY

General CONNOLLY. Mr. Chairman, I am Maj. Gen. Joseph Connolly, U.S. Air Force, Chairman of the Committee for Purchase from the Blind and Other Severely Handicapped.

With your permission, I will submit my written statement for the record and summarize my request.

With me today is Charles Fletcher, Executive Director of the committee.

During 1984, the committee had expanded the benefits of the Javits-Wagner-O'Day Act to increasing numbers of the blind and other severely handicapped. Details of our progress are contained in my prepared statement.

During the past year the committee's action created new jobs for nearly 800 blind and severely handicapped individuals.

The committee's appropriation for fiscal year 1985 was $710,000. We plan to absorb within our fiscal year 1985 appropriation the increase in pay in fiscal year 1985 of about $12,000, resulting from the Federal pay raise which went into effect on Januany 6, 1985.

Our appropriation request for fiscal year 1986 is for $730,000. This is an increase of $20,000 over the appropriation for fiscal year 1985.

The increase is reflected in a number of minor adjustments in our forecasted costs in fiscal year 1986. Our budget request for fiscal year 1986 represents the minimum funds required by the committee in carrying out its responsibilities for expanding employment opportunities for the Nation's blind and other severely handicapped.

Thank you, Mr. Chairman. We will be happy to answer any questions on the details of our budget.

Senator ABDNOR. Thank you, General. I am sorry I am disrupting things here. I had to vote. I don't know how I let that bell get by. I heard that. I guess I was concentrating and forgot to ask myself if it was for a vote.

MEMBERSHIP ON COMMITTEE

Anyway, for the record, would you give us the 15 members of the committee?

General CONNOLLY. Yes; we can. On our committee, we have all of the positions filled, and we will provide the list for the record.

[The information follows:]

COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

MGEN Joseph H. Connolly, Department of Defense.
Mr. Martin A. Adler, private citizen—blind workshops.
Mr. Hugh L. Brennan, Department of Commerce.
Mr. Herbert J. Cohen, Department of Labor.
Mr. George A. Conn, Department of Education.
Mr. Clyde C. Cook, Veterans Administration.
Mr. Earl H. Cunerd, private citizen—employment of other severely handicapped.
Mr. Gerald M. Farkas, Department of Justice.
Mr. Mervin J. Flander, private citizen—employment of blind.
Mr. Frank Gearde, Jr., Department of Agriculture.
Mr. Donald C.J. Gray, General Services Administration.
MGEN Edward Honor, Department of the Army.
Mr. Ira L. Kemp, Department of the Air Force.
RADM Edward K. Walker, Department of the Navy.
Mrs. Joyce C. Young, private citizen—other severely handicapped workshops.

PRICING PROCEDURES

Senator ABDNOR. The committee has established the price that is paid for the services?

General CONNOLLY. That is correct.

Seantor Abdnor. Tell us how that works. What do you do in steps taken to arrive at the dollar amounts?

General CONNOLLY. The way the process begins is that one of the national nonprofit agencies, either the National Industries for the Blind or the National Industries for the Severely Handicapped, presents an item to be put on what we call the procurement list.

This item is given to the committee staff and the committee staff analyze the item. If that item is being purchased by the Federal Gov-

ernment now, we look at the bids that the Government received for the last procurement of the item. We feel that is the best way to establish what we call a fair market price. Using the bids that were received from the last procurement that was made by the Federal Government, we take the median of the bids and we use that median of the bids as the fair market price.

Senator ABDNOR. Does it work pretty well? Do you get much criticism?

General CONNOLLY. It works pretty well. We occasionally get criticism, but the committee staff does an excellent job in analyzing the prices to ensure that we do have the fair market price.

Did you want to add to that?

Senator ABDNOR. If you get a complaint, what form does it come in?

Mr. FLETCHER. We get complaints from both sides.

Senator ABDNOR. Good.

Mr. FLETCHER. The workshops feel our policies are too tight, and the procurement people, who are used to buying products produced at the lowest possible price, consider that the prices are somewhat too high.

On the average, the last time we reviewed this, our prices are about 8 percent above the lowest price for which the Government could have procured the item. We feel that this is certainly well within the range of reasonableness for the prices for the items on the procurement list.

Where the Government has not procured the item before, then the workshop must provide us with details on its costs. We have certain factors based on our experience in pricing products and services that we can use to determine whether or not those cost elements are reasonable. We also get the concurrence of the procurement activities on the reasonableness of those prices.

So we have a check on it both ways.

ITEMS ON PROCUREMENT LIST

Senator ABDNOR. How many items are there?

General CONNOLLY. There are 1,961 items on the procurement list now, for things that the Federal Government buys.

Senator ABDNOR. Do your purchases come from all over the United States?

Mr. FLETCHER. We have workshops in all but four or five States.

Seantor Abdnor. You do.

Mr. FLETCHER. Mr. Chairman, this is the current list of the items which the Government agencies are required to procure from the blind and handicapped workshops. It is broken down into three sections.

The first section is commodities or supplies. The second is household items sold through military exchanges, and the third one deals with services.

Some of the workshops are now providing janitorial services in Federal buildings and commissaries. One service is in process now for Minot, ND.

PAY REDUCTION

Senator ABDNOR. How about the 5-percent pay reduction, is that figured in the budget?

Mr. FLETCHER. It is included in our budget, yes.

COST OF TRAVEL

Senator ABDNOR. You do a lot of travel, right?

Mr. FLETCHER. Basically, I have two industrial engineers who inspect workshops to ensure their compliance with the law and the committee's regulations. We try to inspect a new workshop within 6 months after it begins production, and then to reinspect it once every 2 years.

During the next 2 years, we expect to inspect about 150 workshops, which means that we will be right at the 2-year reinspection schedule.

Several years ago, we got behind on these inspections and we found that a great many workshops were not complying, or were having problems, which we were able to resolve by these inspections.

About 80 percent if my budget for travel is devoted to the travel of those two engineers.

Senator ABDNOR. Your dollar figure will take care of that in the budget?

Mr. FLETCHER. We forecasted exactly the same amount as last year, and we hope air fares and other costs won't go up.

Senator ABDNOR. I do, too, or you may be back.

COST FOR LEGAL SERVICES AND COMPUTERS

Your project cost increases for legal support and computer terminals, what is all that?

Mr. FLETCHER. We are now involved in two court cases. Under other services we are required to reimburse the General Services Administration for the support they provide us. That includes legal support. I am now employing the services of one lawyer at GSA for a large part of her time in connection with these lawsuits, and we expect that this will continue. This will increase our costs of reimbursement to GSA.

As far as the computer support is concerned, since 1979 we have had the same staffing level and during that timeframe through 1986 we expect that the number of actions we will process will just about double.

So I am putting a lot of routine actions on the computer, such as pricing and repricing actions. I expect that we will be expanding computer programming in fiscal year 1986 to try to hold down the backlog we have now in our workload.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Very fine. Thank you for your fine report.

I am going to say that Senator Weicker is chairman of the Labor, Human Services, and Education Subcommittee, and the chairman of the Subcommittee on the Handicapped has questions to ask you. Will you submit them for the record?

Mr. FLETCHER. We will be happy to.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

For the record, please provide a list of all organizations or groups that received grants from National Industries for the Blind since the beginning of NIB's fiscal year 1982.

ANSWER: The Committee does not have that information since it is an activity conducted by the central nonprofit agencies outside the Committee's program.

Provide the amount of each grant to each organization or group and state the purpose for which the funds were provided.

ANSWER: The Committee does not have that information.

How many jobs does the Committee's program provide for the blind and handicapped in direct labor?

ANSWER: In fiscal year 1984 there were 14,134 blind and other severely handicapped persons employed in producing commodities or providing services for the Government under the Committee's program.

What percentage of all direct labor jobs in the workshops does this represent?

ANSWER: The Committee does not have that information.

What percentage of the management and supervisory jobs are held by persons who are blind or handicapped?

ANSWER: The Committee does not have that information.

Is your Committee aware of recent findings by the Department of Labor that Milwaukee Industries for the Blind has not complied with affirmative action for the handicapped requirements of the Rehabilitation Act of 1973?

ANSWER: Yes.

What program does your Committee have in place to inform blind and handicapped workers of their rights to affirmative action for employment and advancement in the workshops?

ANSWER: The regulations regarding affirmative action obligations of Government contractors are published and enforced by the Department of Labor. They are included in Code of Federal Regulations Title 41, Part 60-741.

During fiscal year 1985, how many new positions in management and supervision of workshops were obtained for blind and handicapped persons due to the addition of products or services to the procurement list?

ANSWER: The Committee does not have that information.

How many jobs would you anticipate would be added in management and supervision during fiscal year 1986 to employ the blind and handicapped?

ANSWER: The Committee has no basis for forecasting the number of management and supervisory jobs to be added in fiscal year 1986.

Please explain the Committee's method of approving or disapproving annual budgets of the central nonprofit agencies.

ANSWER: The Committee does not approve or disapprove the annual budgets of the central nonprofit agencies.

Do you evaluate budget needs of the CNA's and direct changes in the commissions they charge to the workshops?

ANSWER: The Committee evaluates the needs of the central nonprofit agencies in order to establish the maximum fee that the central nonprofit agencies may charge their participating workshops?

Please indicate how often within the past five years these adjustments have been directed by the Committee?

ANSWER: During the past five years, the Committee has not changed the limit of 4 percent that the central nonprofit agencies may charge their participating workshops.

Does current law give your Committee authority to require workshops to employ blind and handicapped people in management jobs?

ANSWER: No.

In your judgment, are the blind and severely handicapped fairly represented in the management of the workshops?

ANSWER: The Committee has no basis for answering this question. The Committee encourages participating workshops to employ blind and other severely handicapped in management positions within those workshops and to promote qualified blind or other severely handicapped workers into management or supervisory positions.

As a criteria for designating the central nonprofit agencies, has your Committee developed formal requirements for them to follow in employing blind and handicapped people?

ANSWER: No.

Please explain which jobs at National Industries for the Blind are now being done by blind employees.

ANSWER: The Committee does not have that information.

What is NIB's total work force?

ANSWER: The Committee does not have that information.

What is NIB's total payroll?

ANSWER: The Committee does not have that information.

What amount of NIB's total payroll represents salaries and fringe benefits paid to blind employees?

ANSWER: The Committee does not have that information.

Is it the Committee's position that budget and spending practices of the central nonprofit agencies are beyond the scope of congressional review each year during the appropriations process?

ANSWER: The Committee does not have a position on this subject since it is the prerogative of the Congress to determine what information the Committee must submit to support its appropriation request.

Isn't it true that the total cost of your program includes the commission payments made to the central nonprofit agencies?

ANSWER: No.

What would the total cost of the Committee's program be if you included the amount of the commission payments to the CNA's for fiscal year 1985?

ANSWER: The Committee does not agree that the fee paid the central nonprofit agencies is part of the cost to the Government of the Committee's program.

What do you expect the total cost (including CNA commissions) to be for fiscal year 1986?

ANSWER: See reply to the previous question.

QUESTIONS SUBMITTED BY SENATOR LOWELL P. WEICKER, JR.

The Committee for Purchase from the Blind and Other Severely Handicapped is responsible for the enforcement of the Javits-Wagner-O'Day Act. This Act requires that a sheltered workshop participating in this special program employ blind or severely handicapped individuals for not less than 75 percent of the manhours of direct labor required for the production of commodities or the provision of services undertaken by the workshop.

A 1981 GAO report (Stronger Federal Effort Needed for Providing Employment Opportunities and Enforcing Labor Standards in Sheltered Workshops, HRD-81-99, September 18, 1981) found that sheltered workshops were reporting misleading or inaccurate information regarding the percentage of handicapped individuals engaged in direct labor.

Have reporting procedures been improved and are sheltered workshops conforming with the 75 percent requirement?

ANSWER: Based on the results of the GAO review of sheltered workshops, the Committee revised and strengthened its procedures for inspecting sheltered workshops with emphasis on verifying the accuracy of the reporting of direct labor hours for severely handicapped and non-handicapped workers. The Committee is now inspecting each newly approved workshop within six months after it begins production under the Committee's program and reinspects each workshop every two years thereafter.

No blind workshop was below the 75 percent requirement in fiscal year 1984. Three severely handicapped workshops did not meet the 75 percent requirement in fiscal year 1984. Two of those workshops are no longer producing under the Committee's program and the third workshop reported a direct labor ratio above 75 percent for the first quarter of fiscal year 1985. That workshop is being required to submit quarterly reports throughout fiscal year 1985 so that we can assure that it is continuing to comply with the law during this fiscal year.

Two agencies were authorized by the procurement committee to assist in the administration of the program, the National Industries for the Blind and the National Industries for the Severely Handicapped. A fee of 4 percent of total gross sales to be paid to the central agency by each participating workshop was established in 1968.

The 1981 GAO report found that the 4 percent fee paid by sheltered workshops to the agencies had not been adequately evaluated by the procurement committee.

What steps have been taken to determine whether this fee is reasonable?

ANSWER: The Committee now requires both central nonprofit agencies to submit annually a report of their major programs and activities planned for the upcoming fiscal year 60 days prior to the beginning of that year and a report of their major activities and accomplishments for the past fiscal year within 120 days after the end of the fiscal year.

We are also requiring the central nonprofit agencies to provide the Committee with copies of their budgets and audited financial statements and to relate their budgets to their major programs and activities.

Has the procurement committee determined that the fee should be revised or is 4 percent an appropriate amount for the workshops to pay for the services rendered?

ANSWER: The Committee has not revised the limit of 4 percent it has established on the central nonprofit agency fee. The Committee is now in the process of analyzing the information it has received from the central nonprofit agencies on their fiscal year 1984 operations to determine if a change in the limit on the fee is appropriate.

The Act provides that workshops for the blind are to be given priority for assignment of procurement contracts whenever a new item is added to the procurement list.

How is the blind priority being administered and what actions has the procurement committee taken to assure that new contracts are assigned in a manner that is in compliance with the Act and is responsive to the employment needs of non-blind severely handicapped workers?

ANSWER: When a severely handicapped workshop first identifies a commodity which it believes it can develop the capability to produce, it requests the Committee, through the National Industries for the Severely Handicapped (NISH) to assign the commodity to it for possible future development for addition to the Procurement List. Before assigning the commodity to the severely handicapped workshop, the Committee requests the National Industries for the Blind (NIB), representing the workshops for the blind, to indicate a waiver or exercise of the blind priority established by law. If NIB exercises the blind priority, the blind workshop must take action to add the commodity to the Procurement List within nine months or it is reassigned to the NISH workshop. As provided in the Committee's regulations, the Committee may extend the nine-month period when the blind workshop has been delayed in taking action to request the addition of the commodity by conditions beyond its control.

During the two years ending September 30, 1984 blind workshops added five commodities to the Procurement List which had been nominated by a NISH workshop and for which the blind had exercised the blind priority. The additions represented six new jobs and had a total value of about $500,000. During that same two-year period, NISH workshops added 44 commodities representing 410 new jobs with a value of $13.2 million and 146 services representing 869 new jobs

with a value of $15.1 million for a grand total of $28.3 million. Thus, the exercise of the blind priority reduced the total value of additions by NISH workshops by less than two percent and new jobs by less than one percent. During that period blind workshops added 52 commodities with a value of $19.6 million and no new services.

Although not required by the Act, the 1981 GAO report encouraged upward mobility for workers within the workshop and into competitive employment outside the workshop.

What actions has the procurement committee taken to ensure that handicapped persons employed in sheltered workshops are encouraged to advance into management and supervisory positions within the workshop and into competitive employment where possible?

ANSWER: The subject of advancement of blind and other severely handicapped employees into management and supervisory positions within the workshop and into competitive employment, where possible, has been emphasized in presentations by the Committee Chairman and the Executive Director to all workshop directors at the annual conferences sponsored by NISH and NIB. The Committee staff, during each workshop inspection, reviews the workshops' placement program, including any training programs to prepare employees to move from direct labor into management or supervisory positions, and the results of those programs. Both NIB and NISH have instituted procedures for encouraging and monitoring upward mobility programs in their associated workshops.

SUBCOMMITTEE RECESS

Senator ABDNOR. In concluding our hearings for today, I am sorry for the disruption in my having to leave to vote, but it was carried on by Mr. Parkinson. We thank all of you for your appearances today.

It is going to be a tough budget year for us, you know.

General CONNOLLY. Yes, sir.

Senator ABDNOR. We all know the real challenge. Management by agency heads will have to be exercised diligently and participation in this effort will be necessary and appreciated.

So we have a lot more to do. We appreciate your attendance.

Our next meeting will be Tuesday, March 19, at 2 p.m. in this room. We seem to like afternoon sessions.

We will hear from the Federal Elections Commission, the Advisory Committee on Intergovernmental Relations, Merit Systems Protection Board, Office of Special Counsel, and the National Archives and the Veterans and others.

That is a pretty good load.

With that, the subcommittee stands in recess until that time.

[Whereupon, at 2:45 p.m., Thursday, March 7, the subcommittee was recessed, to reconvene at 2 p.m., Tuesday, March 19.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

TUESDAY, MARCH 19, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–116, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and Proxmire.

FEDERAL ELECTION COMMISSION

STATEMENT OF JOAN D. AIKENS, CHAIRMAN, FINANCE COMMITTEE, AND VICE CHAIRMAN OF THE COMMISSION

ACCOMPANIED BY:
JOHN WARREN McGARRY, CHAIRMAN OF THE COMMISSION
JOHN C. SURINA, STAFF DIRECTOR
CHARLES N. STEELE, GENERAL COUNSEL

OPENING STATEMENT

Senator ABDNOR. It is 2 o'clock, so we will call the meeting to order. I have lost my voice, as you can see. It might be because of too many athletic contests that I have been going to, but I think I also have a cold. Whatever it is, I probably will not be quite as vocal as I have been in other appearances with you folks before me.

This is the second day of our hearings. We are a little behind schedule, I guess, compared to other committees, and today we are going to hear from Mr. McGarry, Chairman of the Federal Election Commission; Mr. Robert Hawkins, Jr., who is Chairman of the Advisory Commission on Intergovernmental Relations; Herbert E. Ellingwood, Chairman of the Merit Systems Protection Board; Mr. William O'Connor, Special Counsel, and Mr. Robert M. Warner, Archivist of the United States.

I do not have any opening statement. Let us get right down to our subject matter. You can always hear from me, so without any other opening statements here—at the moment, I am alone, but other members of the committee very well could drop in during the afternoon.

INTRODUCTION OF ASSOCIATES

So our first witness is Mr. McGarry, Chairman of the Federal Election Commission. He is accompanied by Ms. Joan Aikens, and we are happy to have you back, Joan, as Vice Chairman of the Commission.

So I welcome all of you. Go ahead and introduce the rest of your group and proceed any way you would care to.

Mr. MCGARRY. Thank you very much, Mr. Chairman. Presenting the budget testimony will be the Vice Chairman, Joan Aikens. I might add that we celebrate the 10th anniversary of the Federal Election Commission in a few days—on April 14.

Commissioner Aikens was an original commissioner. When the agency opened its doors 10 years ago, she was there. She is a very knowledgeable person—a font of information on just about everything relating to the Federal Election Commission.

To her left is John Surina, our staff director, Mr. Chairman, and to my right, Charles Steele, the General Counsel of the Federal Election Commission.

Joan is going to give the budget testimony. I only want to make one preliminary comment, Mr. Chairman, and that is this: When the Federal Election Commission appeared here 1 year ago to present its budget testimony, I was the primary witness.

GROWTH IN CAMPAIGN SPENDING

In the course of that testimony, I predicted that the costs of campaign spending for the 1984 election would exceed $1 billion. That prediction came true, Mr. Chairman. The explosive growth in campaign spending obviously is continuing at the same radical pace and it impacts on every facet and aspect of the Federal Election Commission—across the board.

Commissioner Aikens has all the details and I am not going to delay one moment further. It is a pleasure for me to turn over my colleague, my friend, the Vice Chairman of the Commission, Joan Aikens.

Senator ABDNOR. Well, thank you, Mr. Chairman.

I was going to say, Ms. Aikens, you must have left college and come right aboard the Federal Election Commission. [Laughter.]

Ms. AIKENS. Thank you, Mr. Chairman. That is not quite true, but I appreciate the compliment.

PREPARED STATEMENT

Thank you, Mr. Chairman. I am very pleased to appear here today to present the Federal Election Commission's fiscal year 1986 appropriation request. I would ask that our full statement be submitted for the record and, with the chairman's permission, we will summarize our testimony.

Senator ABDNOR. That will be excellent. Your whole statement will be part of the record.

Ms. AIKENS. Thank you.

[The statement follows:]

STATEMENT OF JOAN D. AIKENS

It is a privilege to appear before this Subcommittee to testify in support of the Federal Election Commission's Fiscal Year 1986 appropriation request.

Last August, the Commission concurrently submitted to Congress and the President an FY 1986 request for $13,130,000 and 253 staff years. The request consisted of a base level of funding sufficient to maintain activities at a steady rate, plus several program enhancements that we believe to be meritorious.

Since that initial submission, Commission and Office of Management and Budget staff have been in close contact in an effort to ascertain the appropriate level of resources for Agency operations. While recognizing the concerns of OMB regarding the need to reduce Federal spending, the Commission strongly believes that we must maintain the level and quality of services to candidates, political committees and the public.

OMB has calculated the Commission's FY 1986 base level budget to be $12,756,000. Last month, the President submitted a budget request of $12,433,000 for the Commission for FY 1986. While the enhancements we have proposed will not be possible with this funding, this latter figure is one which the Commission is prepared to accept, providing that the assumptions underlying the OMB recommendation continue to apply.

Tenth Anniversary of the FEC

The Federal Election Commission is approaching a very important milestone. April 14, 1985 will be the tenth anniversary of the day we first opened for business. Throughout those ten years, we have constantly worked to improve every aspect of our operations.

The Commission has now exercised its campaign finance responsibilities throughout five Congressional election cycles,

during which time the amount of funds monitored by the Commission per two-year cycle has tripled. We have administered the public funding program for three Presidential elections, assuring proper accountability for more than $300 million in public money. In addition, we have seen the demand for information from the press and public grow explosively as increased attention has focused on all aspects of campaign financing.

Despite dramatic increases in financial activity and disclosure requests, the Commission has maintained both its staff and budget at a relatively stable level. This has been accomplished with the help of an increasingly professional staff that prides itself in quality service and productivity improvements in every division.

The Commission notes with appreciation the detailed consideration given to its annual budget request by its authorization and appropriation committees. Congressional understanding of the unique circumstances facing an agency which oversees campaign finance has been critical to our success.

The Administration's Budget Request

The Commission's acceptance of the $12,433,000 Administration recommendation is based on our analysis that this amount will permit us to address the demands of the 1986 elections at the same level of effort sustained in previous years. As noted previously, OMB has calculated the Commission's FY 1986 base level budget to be $12,756,000. This represents the resources adequate to maintain program activities at a level consistent with FY 1984 and FY 1985 should other considerations remain the same. From this, however, OMB has deducted $323,000 to account for a five percent reduction in personnel salaries.

Should the pay cut not be enacted, the base level necessary for steady-state maintenance of Commission operations without disruption is $12,756,000. Because we are a highly personnel

intensive agency and have other major fixed costs (such as rent and data processing), the impact of cuts below $12,756,000 would be severe should the President's pay reduction plan not be enacted.

It is appropriate at this time, Mr. Chairman, to also note that the Commission and OMB are both supporting a Fiscal Year 1985 supplemental appropriation for the agency of $115,760. This represents 50 percent of increased pay costs already enacted this year. The agency will absorb the other 50 percent in accordance with OMB guidance.

Staffing Level

There remains one residual issue which has not yet been resolved with OMB. This relates to the Commission's staff year ceiling. For the last two years, we have been operating under a ceiling of 245 Full Time Equivalent (FTE) staff years. This is consistent with the allowance specified in Appropriation Committee reports. OMB, however, asserts in the budget that the ceiling should be 236. Since OMB has approved a Commission request which accommodates funding for 245 employees, we believe this to be a technical error which we are working with OMB to resolve.

Proposed Enhancements

In developing its August budget request, the Commission carefully reviewed a long list of proposed enhancements to the base. The benefit of each proposal was carefully weighed against the projected cost. Only five items, totalling roughly one-half million dollars, were included. While these, as well as other worthwhile projects, will have to be deferred until fiscal restraints are eased, I wish to briefly highlight these projects for the committee.

-- Remote Access - Expanded Project: $225,000 and 3 FTE. Assuming favorable evaluation of the pilot project now underway, remote access by Secretaries of State to the

FEC disclosure data base would be offered to all 50 states. We anticipate that half the states will choose to participate. The Commission would pay for data processing, travel, and staff support. Each state would provide its own equipment, supplies and operating personnel.

-- Regulations and Policy Program: $90,000 and 4 FTE.
Increased personnel in the Office of General Counsel would provide additional assistance to the Administrative Law and Regulations sections to meet an increasing workload. Two staff members would be assigned to systematic review of Commission regulations.

-- Systems Manuals: $50,000.
Outside contracts would help revise Presidential Finance Systems Manuals for primary and general election candidates receiving public funds.

-- Clearinghouse Contracts: $80,000
The Commission would use half this amount to update a 1975 project on Absentee Voting and the other half to update a 1978 project on Ballot Access. Each one is a compilation of the various rules and practices of the different states. Laws and court rulings have changed significantly since the original study was completed.

-- Information/Outreach Equipment: $35,000.
New equipment would be purchased to facilitate the mailing of informational and press materials, replacing items that are outdated and inadequate to meet the Commission's current needs.

Handicapped Access

The Commission's August request included $50,000 to carry out our responsibilities under the Voting Accessibility for the Elderly

and Handicapped Act (Public Law 98-435). Although this legislation was not enacted until after our initial request was submitted, we included a contingent request to cover anticipated travel and staff expenses.

The statute requires chief state election officers to report to the Commission on the accessibility or inaccessibilit of polling and registration places within the state with respect to each of the next five two-year election cycles. Beginning in 1987, the Commission is to compile the information and report to Congress by April 30 of each year following an election. We have estimated that fulfilling this obligation will cost $50,000 per year in the early years of the program. Reporting formats will have to be developed in consultation with both the states and groups representing handicapped and elderly voters. The requested funds include $20,000 for travel and printing and $30,000 for one additional staff year.

The Commission views its obligation under the Handicapped Access Act very seriously and intends to give it priority attention. Thus, this request should not be characterized as an enhancement; it is a necessity. Should the additional funds not become available, however, the Commission will use existing resources to compile the report. The Commission has already initiated the planning process to determine what steps need to be taken and to establish deadlines for completion of various tasks. All operations of the National Clearinghouse on Election Administration are currently being reviewed. A decision on which projects will be undertaken is expected to be made in the near future.

The 1984 Election

The 1984 election was, as predicted, the most costly in our history. November 6 was an important date, but clearly it did not mark the end of our work associated with the 1983-1984 election cycle. A presidential election cycle is clearly our busiest time.

In some respects it is our most satisfying time as well as we witness our exceptional staff respond to the challenge.

The year end reports from candidates and political committees active in the 1984 elections came in a little more than one month ago. While not all of this data has been computerized and verified, I would like to share with you some preliminary data that you may find interesting.

228 individuals registered with the Commission as candidates for President in 1984; of these, 39 had at least $5,000 in financial activity and were required to report their receipts and expenditures to the Commission.

11 candidates qualified for primary matching funds. Thus far, slightly over $36 million in such funds have been certified.

$80.8 million was certified from the Presidential Election Campaign Fund for the two major presidential candidates for the general election.

The nominating conventions of the Democratic and Republican Parties were each certified $8.08 million for a total of $16.16 million.

Audits are underway to ensure proper expenditure of all public funds. Some audits have already been concluded and their results publicly released.

2,023 House and Senate candidates participated in the nomination and election process during the 1983-1984 cycle. They spent approximately $374 million.

255 Senate candidates spent $170 million.

1,768 House candidates spent $204 million.

4,009 PACs were registered as of December 31, 1984. Of these 2,826 PACs reported contributions to 1984 candidates of $103 million.

All PACs raised $284 million, and spent $256 million, figures that include fundraising and administrative costs, as well as contributions and expenditures.

107 PACs made $18.4 million in independent expenditures on behalf of candidates; 38 PACs made $2 million in independent expenditures against candidates.

This is partial data for 1983-84. Complete statistics will be released in the near future.

FEC Activity

While these totals are impressive, so are those relating to FEC activity during 1984:

56,521 documents from candidates and committees were processed by the Reports Analysis Division. Despite the fact that they were initially filed with three different offices, all were microfilmed and made available for public inspection within 48 hours of receipt.

First summary data and microfilm location and then detailed information are coded and entered into the Commission's computerized data base for these reports.

Analysts must review reports to ensure compliance with the requirements of the law.

Almost 1.4 million pages of campaign finance material were placed on the public record in the course of the year.

30,423 people visited or wrote our Public Records Office.

95,372 printouts of campaign finance information were provided to public requestors.

$80,203 was returned to the Treasury from FEC document sales.

84,665 callers were assisted by our Public Information staff; an additional 15,317 telephone inquiries were handled by the Press Office.

75,554 informational packages and notices were mailed out by Public Information.

59 Advisory Opinions were issued by the Commission.

283 compliance cases opened--163 by external complaint and 120 internally-generated--and 189 closed during the year.

At the end of the year, the Commission was in court on 32 different matters.

I have appended to my statement four graphs. Three of these document the explosive growth since 1976 in campaign finance activity, the number of political action committees, and informational requests received by the Commission. The fourth shows Commission staffing over this same time. As you will note, personnel levels have remained relatively constant. We have dealt with our growing responsibilities without a comparable increase in staff.

Commission Relocation

Last year, when the Commission appeared before this Committee, we pointed out to you safety and operational problems in the building we occupy. Funds were earmarked in our FY 1985 appropriation for relocation, and it now appears that the FEC will move before the year is out.

A suitable building has been identified for the Commission. GSA is now negotiating final lease details. Some unanticipated delays were encountered late last year, but they were resolved after some extraordinary assistance from Members and staff on our appropriations and oversight committees and from those on the Public Works Committees. As promised, funds earmarked for the move are being accounted for separately, and any money not needed for this purpose will be returned to the Treasury.

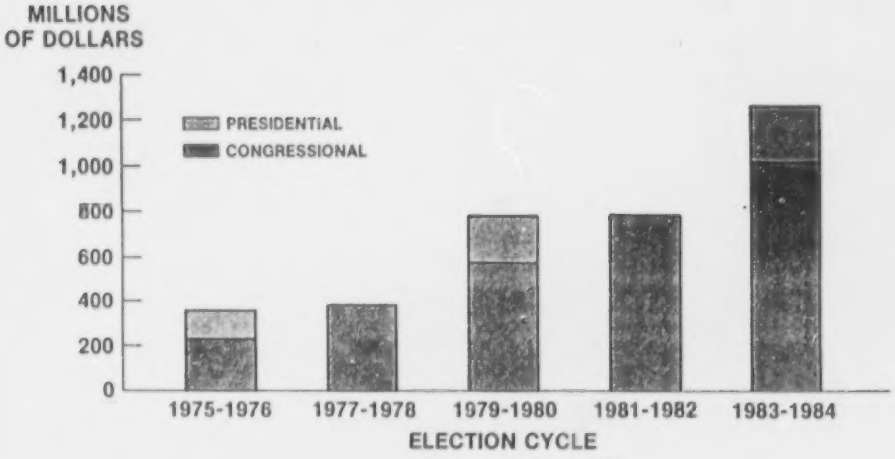
Conclusion

Relative to the overall government apparatus, the FEC is a miniscule agency. In terms of the Federal budget, we make up around one one-thousandth of one percent. Humbling as this reality may be, it does not diminish the critical role the Commission plays in the American political process and the intense scrutiny to which our actions are subjected by the press, the regulated community and the Congress.

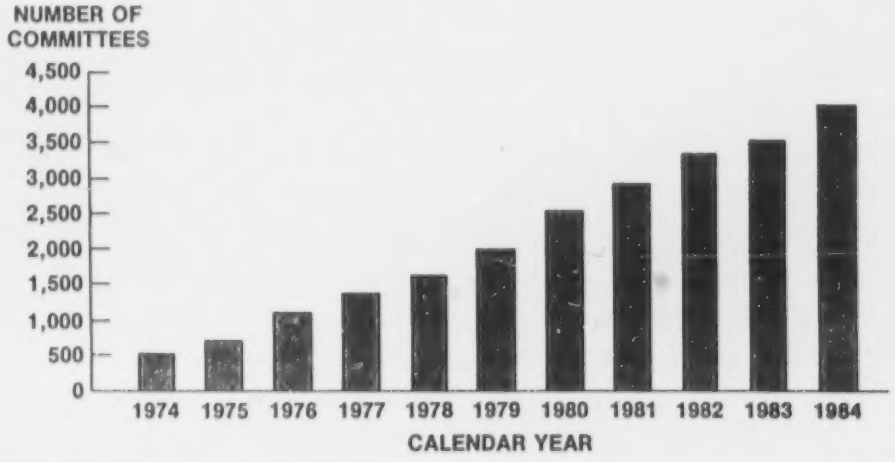
The chemistry of a small organization assigned a high profile and sensitive mission yields responsiveness. We now have ten years' experience in adapting to program changes flowing from amendments to the law and court interpretations. Changes also come from within as we devise more efficient and effective ways to meet our obligations. Within the ever-present limitations on our resources and authority, we take considerable pride in what we do and how our objectives are being achieved. Given the continuing support of this committee and others charged with jurisdiction over our program and funding, we look forward to the next decade with confidence.

We will be pleased to respond to any questions you may have.

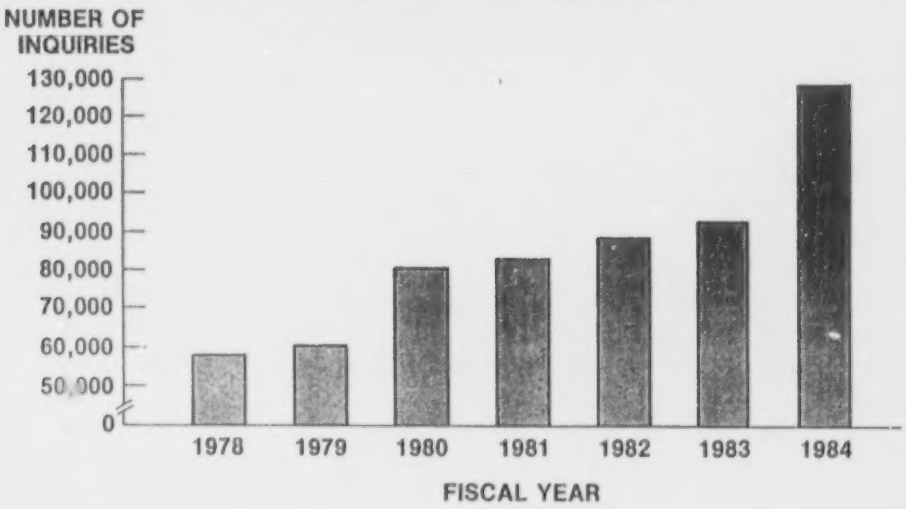
DISBURSEMENTS IN FEDERAL ELECTION CYCLES



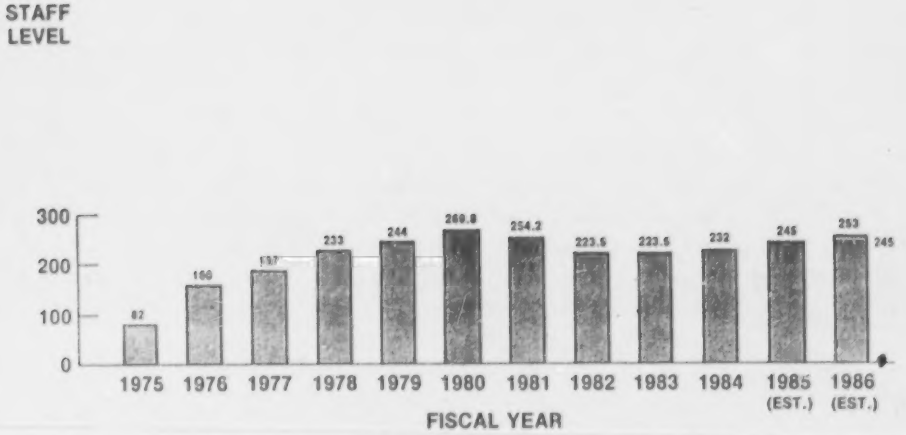
NUMBER OF NON-PARTY COMMITTEES



TOTAL INFORMATION REQUESTS: CALLS, VISITS, LETTERS



STAFF BY FISCAL YEAR



NOTE: STAFF LEVELS FOR FY 75-79 REPRESENT PERSONNEL LEVELS, FOR FY 80-86 REPRESENT FTE (FULL TIME EQUIVALENT)

BUDGET REQUEST

Ms. AIKENS. Last August, the Federal Election Commission submitted to the Congress and the Office of Management and Budget a fiscal year 1986 request for $13,130,000 and 253 staff years. This request was based on our fiscal year 1985 appropriation, adjusted for a cost-of-living increase, and minus the one-time cost for relocation and renewal of our computer contract, plus several programs that the Commission felt worthwhile.

OMB calculated our base level at $12,756,000, and then deducted the proposed 5-percent pay cut. The President, therefore, submitted a budget request to Congress of $12,433,000. If the pay cut does not, in fact, pass, our request to this Committee for this year will be $12,756,000.

We believe this figure will adequately fund the operations of the Commission through the 1986 election, though it may not be sufficient to undertake any or all of the additional programs in our August request.

These additional proposals are described fully in the statement submitted for the record. However, there is one special program which I would like to detail for this Committee's consideration—the expansion of the remote access project.

REMOTE ACCESS PROJECT

This program, begun last year as a pilot project, provided remote access to the FEC's disclosure data base at six sites in five different States. The project operates in conjunction with, and funding is shared by, the secretaries of state in the States which wish to participate.

The project is currently being evaluated and the preliminary responses are extremely favorable. Access has now been expanded to eight sites, with about seven more States requesting participation. We would like eventually to offer the project to all 50 States, thus greatly expanding and enhancing the disclosure aspects of the FECA.

We would project a cost of approximately $225,000 in fiscal year 1986 for this program.

FEC WORKLOAD AND STAFFING TRENDS

As we approach our 10th anniversary on April 14, 1985, I would draw your attention to the charts at the end of the table that we have had prepared. These charts reflect the dramatic growth in financial activity in the last decade and the ever-increasing public interest in all aspects of campaign financing.

The first chart in the upper left-hand corner, the green chart, shows the increase in disbursements in each Federal election cycle since 1976, when the total was approximately $353 million, to 1984, when it rose to over $1,250,000,000, the figure predicted last year by our Chairman, Commissioner McGarry, in testimony before the committee.

The 2,023 House and Senate candidates registered in the 1984 election cycle spent approximately $374 million, tripling the amount spent

in 1976. The final report of financial activity for the 1983–84 election cycle will be released by the Commission in early May, totaling receipts and disbursements reported through the year-end reports.

The second chart, the orange chart in the right-hand corner, points out the growth in the number of nonparty committees which have registered with the Commission in the 10 years of our existence, from 608 on January 1, 1975, to 4,009 by the end of 1984.

These PAC's spent approximately $256 million, with about $103 million reported as contributions to candidates. These two graphs give some idea of the explosive growth in the workload that our staff faces.

The third chart, the blue chart in the lower left-hand corner, shows the total information requests made to the FEC and how they have increased since 1978, the first year for which we have complete records.

Included in these figures are all informational requests, calls, visits, and letters. As can be seen, requests have more than doubled from 58,402 in 1978, to almost 130,000 in 1984. To give some idea of what is involved in this, our public information staff logged 84,665 phone calls, and the press office handled an additional 15,317 inquiries in calendar year 1984.

To satisfy the increasing interest in campaign financing, the Commission has made every effort to make more data available ever more quickly and in more useful formats through our Press Office and our Public Records Office, in the numerous publications we have put out, in training seminars, on our 800 line, and, as mentioned, through the remote access project.

By the end of 1984, 5.59 million pages were put on the public record—1.4 million in 1984 alone. I would like to report that $80,203 has been returned to the U.S. Treasury from FEC document sales in 1984.

The final chart, the red chart in the lower right-hand corner, shows the level of staffing by fiscal years remaining fairly stable since 1978, and even decreasing slightly while the workload was growing.

Since we are a personnel-intensive agency, our budget has likewise remained relatively stable, though showing an increase for the cost-of-living adjustment each year. This illustrates more dramatically than words could ever describe the dedication of the entire FEC staff and their desire to provide quality service to our constituency and the interested public.

Charts, however, cannot show the deep appreciation and immense pride we, the Commissioners, feel toward so loyal and efficient a staff.

1984 PRESIDENTIAL ELECTION FUNDING

Finally, let me report to this committee on the public financing of the 1984 Presidential election. In the 1984 elections $133.3 million was certified from the fund.

Senator ABDNOR. How much is that?

Ms. AIKENS. $133.3 million.

Eleven candidates qualified for matching funds in 1984 and received over $36 million; $80.8 million was certified for the two major party

candidates in the general election. These figures have exactly doubled since 1976, increasing in each election cycle by approximately $30 million. Each year, the entitlement is adjusted based on the Consumer Price Index.

We have had prepared a chart which tracks spending from the fund since 1976, as well as the rate at which the fund has been replenished. As can be seen, the amount checked off each year has remained at a steady rate, approximately 25 percent, adding about $35 million to the fund each year. The fund balance now is just over $90 million.

VOTING ACCESSIBILITY ACT

There are two more items I would like to bring to the committee's attention. The first is the FEC's responsibilities under the Voting Accessibility for the Elderly and Handicapped Act.

The Commission's August budget request of $13,130,000 included a contingent request to cover travel and staff expenses for our responsibilities under this law. We want to assure the committee that we intend to give this program priority attention and, in fact, have already begun some preliminary planning.

We will, if necessary, use existing resources to discharge our obligations under this law.

RELOCATION OF FEC OFFICES

Finally, the relocation of the FEC offices: GSA has identified a location for the Federal Election Commission and preliminary planning has begun. The funds earmarked for this purpose in fiscal year 1985 will hopefully permit the relocation to take place before the fiscal year is over.

As promised, these funds are being accounted for separately and the unused portion will be returned to the Treasury. Our new address will be 999 E Street, Northwest.

Mr. Chairman, in closing let me thank you and the members of this committee for the support and assistance given to the Commission over the 10 years of our existence. We realize our budget request each year is a tiny drop in the overall budget sea, just one one-thousandth of 1 percent. But we are nonetheless humbly aware of the importance of our role in the political process.

We take pride in the job we are doing and look forward with confidence to our second decade. We urge consideration of our budget request of $12,756,000. We will be pleased to answer any questions, and thank you again for the opportunity to make this presentation.

Senator ABDNOR. Well, thank you, Commissioner Aikens.

We are now joined by Senator Proxmire. Did you want to make an opening statement of any kind?

Senator PROXMIRE. I have no opening statement. I have some questions.

Senator ABDNOR. All right.

INCREASE IN ACTIVITY

I want to commend you on your fine testimony. It certainly sets out your work very clearly. It is amazing the way your growth has gone on, and obviously you have done it very efficiently as far as manpower.

Why the big change in the blue in 1983 to 1984?

Ms. AIKENS. In a Presidential year, we had a tremendous amount of inquiries.

Senator ABDNOR. Well, you have got other Presidential years there.

Ms. AIKENS. In 1980 there was a large jump. Again in 1984 there was a large jump. It levels off just a little bit after each Presidential election period.

Senator ABDNOR. No particular reason other than——

Ms. AIKENS. Just because of the Presidential year and the greater interest, I suspect.

SUPREME COURT DECISION

Senator ABDNOR. Yesterday, the Supreme Court made some kind of a monumental ruling here on PAC's. What are your thoughts on that?

Ms. AIKENS. I will let the Chairman answer that question, Mr. Chairman.

Senator ABDNOR. All right.

Mr. MCGARRY. We were asked this morning, Mr. Chairman, at another hearing, with reference to that case why do we pursue losers. It is interesting that in the Washington Post this morning, an article indicated that one of the litigants in that case made a statement that the Federal Election Commission would have to stop its bureaucratic tyranny.

The decision was issued by the Supreme Court yesterday; it has only been available overnight. But it is interesting that in the opinion, the court went out of its way to say that the Federal Election Commission acted properly in finding that NCPAC, in making the independent expenditures it did, was in violation of the law. The section of the law at issue was put on the books by Congress and it refers to independent expenditures on behalf of Presidential candidates who have accepted public funding.

The section of the Presidential Fund Act involved—9012(f)—provides that if a Presidential candidate accepts the option of public funding, independent political committees are limited to $1,000 in independent expenditures to support that particular candidate.

The underlying theory of Congress in putting that on the books was that in giving a public grant of public moneys to a Presidential candidate, groups should not be allowed to come in and spend unlimited amounts of money by way of independent expenditures.

The theory was a good one. The court pointed out that the Federal Election Commission did exactly what it was obligated to do. We are created to administer and enforce the law; we are doing exactly that.

The court went on to find that that particular law was unconstitutional. In my opinion, Mr. Chairman, it is not our role to be picking

and choosing which sections of the law are constitutional. We did exactly what we had an obligation to do.

Personally, I am delighted the court went out of its way to say that what we did in finding a violation of that section was absolutely correct. In any event, it is not, I am sure, without controversy. I say this only to point out that the Commission was following the law—doing what it is mandated to do to administer and enforce the law.

Senator ABDNOR. Now, you more or less have to rest with the decision laid down.

Mr. MCGARRY. The Commission in no way will quarrel with the court, finding it is unconstitutional. We will adapt, adjust, and make all the necessary changes. The court has spoken; that is its function. It is not for us, in my opinion, to determine which sections of the law are constitutional or unconstitutional.

Ms. AIKENS. If I could just add, Mr. Chairman, I believe that the impact of the Supreme Court ruling on the Commission will be minimal as far as operations is concerned. There are very few matters currently before us involving that section of the law, so I do not think it will have a great impact on our operations.

REMOTE ACCESS PROJECT

Senator ABDNOR. You were talking about remote access. Do you have the dollars in your budget for that expansion you are talking about?

Ms. AIKENS. The dollars are included in the $13,130,000 August request, but not for the full program at $12,756,000.

Senator ABDNOR. Well, that depends on the pay raise?

Ms. AIKENS. Yes; but that is the number we are requesting, the $12,756,000.

Senator ABDNOR. If they determine that there shall not be one, then the money will be there for this remote access, too?

Ms. AIKENS. Not at $12,756,000, it would not. The pay cut would take our figure back to $12,433,000. If the pay cut did not go through, there would be little money for even what we are doing right now.

EFFECT OF POSSIBLE REDUCTIONS

Senator ABDNOR. Well, are you going to be able to carry on some of the programs you have in your statement?

Ms. AIKENS. We would hope that we could undertake some of them. We would hope that we would be able to find the funding for some of them. For instance, in our original request, there was $50,000 for our responsibilities under the Handicapped Access Act.

We have already determined that no matter what it takes, we will satisfy our obligations, even if we have to use current resources and divert them from other programs.

PRODUCTIVITY INCREASES

Senator ABDNOR. Well, obviously, your workload has increased significantly and your numbers—I am not trying to push more people on you at all, but is the automation helping you and what makes it possible for you to do all this extra work?

Ms. AIKENS. Our productivity has increased tremendously over the years and our staff has managed to handle the load. Almost the entire staff worked overtime, long hours, or Saturdays through 1984, and managed somehow to increase productivity to the point where we got the job done, and done successfully.

Senator ABDNOR. Well, fine.

Senator Proxmire?

Senator PROXMIRE. Thank you, Mr. Chairman.

PUBLIC FINANCING OF ELECTIONS

The Federal Election Commission has now had experience administering a system of public financing for Presidential elections for three elections. Most observers agree that this approach to election reform has worked well.

From your viewpoints as administrators of the law, do you agree?

Ms. AIKENS. I think it is working very well, yes, sir.

Senator PROXMIRE. Suppose Congress decided to institute some form of public financing for congressional elections, would you anticipate any unusual problems in administering such an expansion of the law?

Ms. AIKENS. The addition of staff, obviously—audit staff.

Senator PROXMIRE. It would take more resources, obviously, yes. We not only have more money spent, as you can see in the first chart there, but far more elections and every election would have to be policed, I presume.

Ms. AIKENS. I would assume that the checkoff would have to be increased to handle additional congressional races.

PAC ACTIVITY

Senator PROXMIRE. Yesterday, as the Chairman has pointed out, the Supreme Court struck down as unconstitutional a limit on the amount of money PAC's could spend on behalf of Presidential candidates.

In congressional races, PAC's have assumed an ever-growing importance and contributed about 30 percent of the total during the last election. In addition, PAC's favor incumbents by a 3-to-1 margin, which is one of the reasons why 95 percent of the incumbents running for reelection in the House last year were reelected.

It is almost automatic, and it seems to me that it is an unfortunate situation that you have that disparity in financing. Do you think that PAC's could become this important in Presidential elections, as important as they are with the Congress, contributing as much as a third to the Presidential elections?

Ms. AIKENS. No one is allowed to contribute to the general election

campaign for President under the public financing system. This is independent expenditure spending by PAC's that the Supreme Court decision——

Senator PROXMIRE. Well, that is what I am talking about. I am talking about the independent expenditure by PAC's.

Ms. AIKENS. I assume there will be more money spent independently now. However, that is not always helpful to the candidate running. Sometimes the money is spent in opposition to candidates.

Senator PROXMIRE. Well, of course. If it was spent in opposition to candidate A, it helps candidate B. I hope all that money is spent in opposition to the Republican candidates, but I do not expect that will be the case. [Laughter.]

If more and more money is spent by PAC's in Presidential campaigns, it could become a big factor and I would think that you might have more spent for incumbent Presidents than for people who are not incumbents.

Ms. AIKENS. I would think so, yes.

Senator PROXMIRE. The same thing you have in the Congress—you back the guy whom you think is going to be the winner because you want to obligate him.

Ms. AIKENS. Yes.

Senator PROXMIRE. Well, frankly, I am very disturbed by this. I think we are putting the political office on sale. One PAC head said to the Wall Street Journal, frankly, about 2, 3 or 4 years ago, "When I make a contribution for my PAC, I buy legislation."

Well, of course, a lot of people who accept contributions from PAC's do not feel that way, but the PAC's feel that way and I think the public does to some extent, and I think to some extent it is true. That is why they do it. They are not just fellows who, by and large, are out for any ideal reason. They form a PAC because they want to advance their political position and their advantage under the tax laws, or whatever.

IMPACT OF REDUCTIONS

Your original budget request to OMB back in August of 1984 was $13,080,000 and 253 positions. The President has approved a budget request of $12,433,000 and 236 positions. This represents a cut of about $500,000 below the appropriations you received in fiscal 1985.

What specific measures would you take next year to absorb this cut in both dollars and people and still handle your postelection workload and your other responsibilities?

Ms. AIKENS. We are hoping for the $12,756,000 we are asking for, not the figure of $12,433,000 that the President's pay cut contemplates. Under $12,756,000 we expect to be able to operate at the rate we are now and, if we can increase productivity, maybe absorb some of the programs that are desirable for the Commission and not fully funded.

COMMISSION EFFECTIVENESS

Senator PROXMIRE. I think it is a great-looking Commission, and I am sure that you are very efficient. But it is hard to understand—maybe you can give a lesson to all the other agencies on how you can be so productive, that you can get along on no increase to speak of, or very little over the years, and yet do so much more work.

Ms. AIKENS. We really do it. The figures are right there.

Senator PROXMIRE. Are you policing this, do you think, as effectively as you should?

Ms. AIKENS. I think we are. We are constantly reviewing procedures, methods, and programs, and monitoring ways to do things better. The staff has been——

Senator PROXMIRE. Why are there not more candidates who are put in jail? [Laughter.]

Ms. AIKENS. Because they are not doing more things bad.

Senator PROXMIRE. Well, I hope that is the case, but I kind of wonder.

DEFERRED PROGRAMS

What are the items that you requested back in August, but will have to do without under the President's budget request and under your modification which you have properly pointed out?

Ms. AIKENS. There are five programs which we requested. We looked at a much longer list and selected these five as the most meritorious for this stage. The first one is the remote access project which I spoke on earlier. I do not believe you were here, Senator.

This is a project which was begun last year, a pilot project providing remote access to the data disclosure base of the FEC in various State capitals. We started on the pilot program with six sites in five different States, and have since added two more States.

Seven more States have requested to be included in this project. This greatly enhances the disclosure. We would like to offer it to all 50 States. We do not think all 50 would want to participate, but to offer it to all 50 States, we have a projected budget of $225,000.

We would not be able to do all of that, or perhaps any of it, at the $12,756,000 level, depending on our workload and several other factors.

Senator PROXMIRE. You will not be able to provide the disclosure and the discipline that that would provide?

Ms. AIKENS. We would not be able to include all 25 or 50, or whatever total number of States wished to participate. We may be able to expand it a few, but we certainly would not be able to offer it to 25 or all 50.

We are requesting four more personnel in the General Counsel's Office. Two are for assistance on administrative law—that is, non-FEC matters like the Freedom of Information Act requests, the Sunshine Act, EEO—those types of legal questions that have to be dealt with and the Commission has to be advised on. We were asking for two more staff people to do a review of the regulations, starting from page 1 and

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going right through and systematically revising whatever regulations need revising. These four positions carry a price tag of $90,000.

We asked for $50,000 to provide for a revision of the Presidential finance systems manuals. These are the bookkeeping manuals that we prepare for the publicly financed candidates to help them report properly and stay out of trouble. One of the reasons our productivity has increased is because of all these manuals and publications we have put out, trying to inform people of how best to comply with the law.

These systems manuals need revision before the 1988 election. We would like to start on it as soon as possible in order to get it done in time.

We have proposed $80,000 for clearinghouse contracts, $40,000 to be used to update a 1975 project on absentee voting laws, and the other half to update a 1978 project on ballot access in the various States. Both of these contain valuable information to the election community in general. We have had a lot of requests and both need revision very badly.

Finally, we have asked for $35,000 for some update of some equipment, mailers and sorters, and that sort of thing.

Senator PROXMIRE. Thank you, Mr. Chairman.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. I have other questions, but I think we will just submit them for the record. We have a number of other witnesses with us today.

Ms. AIKENS. Yes, sir.

Senator ABDNOR. Chairman McGarry, Commissioner Aikens, we thank you for your fine testimony.

Ms. AIKENS. Thank you.

Senator ABDNOR. You are doing a good job. I think it is amazing with the workload you have that you keep up, and we wish you further success.

Ms. AIKENS. Thank you very much.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. The Commission is currently sparring with OMB as to the staffing level. How did the disparity arise? What is being done to resolve it?

Answer. The FEC has notified OMB of the congressionally approved FTE ceilings of 245 the past 2 fiscal years. We have also notified OMB of the need for 245 positions in fiscal year 1985 and in fiscal year 1986. We have formally appealed the OMB FTE figure, and will continue to followup this appeal. We are currently reporting a cumulative FTE of 245.8 for fiscal year 1985, and project achieving our ceiling of 245 for the year.

The FEC believes the disparity arose from OMB using out-of-date data concerning our FTE, and did not consider our staffing level at the time of our budget submission (which was over 245 FTE.) We have consistently reported a cumulative FTE of over 245 so far in fiscal year 1985.

Question. The Commission's ADP contract expires this year. What steps are being taken for the future? You have basically been firefighting. Will the possibility of expansion functions be considered?

Answer. The Commission's ADP contract expires in fiscal year 1985. This contract provided for 6 years of sole use of a leased system on a 24-hours-a-day basis. The original estimates for 6 years of growth in financial activity have been exceeded by the actual increase in campaign finance activity. Therefore, the usage of the present system has reached its full level of capacity. This is not unexpected in the final year of a 6-year contract in a growth activity.

The Commission is currently in the process of reprocuring a new ADP contract which will provide for expanded capabilities as well as projected growth in the future. We anticipate completing the procurement process during 1985. Despite the full utilization of current ADP capacity, the Commission has been able to meet computer demands through the use of supplemental add-ons to the base contract. In fact, the Commission has also expanded its activities to include providing access to the FEC disclosure data base in what will soon be eight remote sites at Secretary of State offices across the United States (Washington, California, Colorado, Georgia, Massachusetts, Illinois, Alabama, and Rhode Island).

Question. Access to FEC information is very important. You have a State Access Program. Would you explain briefly how it works?

Answer. A brochure fully describing the remote access project follows for the full information of the committee.

State Computer Access to FEC Data

INTRODUCTION

What PAC's are backing Senator Smith's reelection bid? How much money is Candidate Jones spending on her congressional race? Which Federal candidates is basic PAC supporting?

You can quickly find answers to these questions by means of computer terminals in several State government offices located throughout the country. (Check the back page for the office nearest you.) With the aid of the computer, you can access data on the campaign finances of Federal candidates and the political committees that support them. (Federal candidates are those running for President, for Vice President and for seats in the U.S. Senate and House of Representatives.) This computerized information, once available only from the Federal Election Commission [FEC] in Washington, DC, is offered through a cooperative effort between State election officials and the Commission.

The FEC is the depository for campaign finance reports filed by all political committees participating in Federal elections. Data from these reports are entered into an FEC computer that is linked, via a national telecommunications system, to the terminals in the State offices.

In the past, you may have used copies of actual campaign finance reports filed at a State records office by Federal candidates seeking election within that State and by political committees that support those candidates. Now, the computer will generate an individual printout on any Federal candidate or political committee throughout the United States. You can avoid spending hours copying information from reports or paying fees for photocopying pages.

HOW TO OBTAIN COMPUTERIZED INFORMATION

Present your research needs to the staff at the State records office. Using the computer terminal, a staff member will identify the specific information you want and instruct the computer to print it.

For example, you might ask: How much money had Candidate Smith raised and spent in his campaign? In response, the staff member would ask the computer to list the campaign's receipts and disbursements.[1] A computer printout containing this information would be generated for your personal use.

[1] The printout lists total receipts and disbursements for the election cycle for the principal campaign committee. If the candidate has other authorized committees, the printout also lists, for each of those committees, total receipts and disbursements for each reporting period, but does not give election-cycle totals. Because committees within a campaign sometimes transfer funds between themselves, merely adding the committees' totals for each reporting period could result in an inflated amount for the election cycle.

Here is a sample list of other questions you might ask:

- How do Candidate Brown's campaign finances compare with her opponent's?
- How much money has basic PAC raised and spent?[2]
- Which candidates are supported by basic PAC?
- Which PAC's support Candidate Wilson?
- Does basic PAC have a sponsoring corporation or union?
- How much money has the State party spent to support its nominee in the Senate race?
- Has anyone made independent expenditures[3] for or against Candidate Wilson or his opponent?

COMPUTER PRINTOUTS

These questions may be answered by using computer printouts generated by the terminal in the State office. Printouts vary in format, depending on the kind of information requested. Several basic types of printouts are available, as described below:

Funds raised/spent by committee (Index C)

This type of printout lists the name of a specific committee registered with the FEC along with the total amount the committee raised and spent within each reporting period and during a 2-year election cycle (the year before a general election and the year in which the election takes place). The printout also lists all the committee's documents on file at the FEC.

Committee's support of candidates (Index D)

This kind of printout gives you information on a PAC or political party committee. For each committee being researched, the printout shows:

- The committee's corporate or labor sponsor (if any);
- Whether the committee has qualified as a multicandidate committee, that is, one that is eligible to give a Federal candidate up to $5,000 per election (rather than the $1,000 permitted other political committees);
- The specific candidates supported or opposed and the amount spent for or against a candidate; and
- The total amount a committee spent to support or oppose candidates through contributions, independent expenditures and coordinated party expenditures.[4]

Candidate information (Index E)

For the particular candidate selected, this type of printout gives you a list of information, including:

- The candidate's party affiliation and the office he or she is seeking;
- The names of the candidate's principal campaign committee and other authorized committees;
- Funds raised and spent by the campaign during an election cycle;[5]
- The names of committees that supported or opposed the candidate during an election cycle and how much they spent on contributions, independent expenditures and coordinated party expenditures;[6]
- The sponsoring organizations of the corporate and labor PAC's listed; and
- The corporations and unions that reported supporting or opposing the candidate through internal communications, and how much treasury money they reported spending in this activity.

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[2] PAC (political action committee) refers to a political committee that has not been authorized by any candidate or political party. The term encompasses PAC's sponsored by corporations and labor organizations (trade, industry and labor PAC's) and nonconnected PAC's, that is, those without corporate or labor sponsors.

[3] An independent expenditure is money spent for a communication that advocates a specific candidate's election or defeat. The expenditure is "independent" in that the PAC may not consult or cooperate with the campaign benefiting from the expenditure. 11 CFR Part 109.

[4] Party committees alone are permitted to make coordinated expenditures. Limited in amount, these expenditures promote the party's candidates in the general election (not the primary). The expenditures may be coordinated with the candidate's campaign, but the party committee pays the bill, 11 CFR 110.7.

[5] See footnote 1.

[6] Note that the index's list of amounts raised and spent by a candidate's campaign does not necessarily cover the same time period as the list of amounts spent by committees to support or oppose the candidate.

FURTHER INFORMATION AND ASSISTANCE

State records offices

State records offices maintain copies of campaign finance reports filed by candidates and political committees active within the State. The State offices listed on the back page also maintain reference copies of printouts containing certain kinds of FEC data that are not accessible through the terminals. Information available in the printouts is described below:

- "FEC Reports on Financial Activity" is a series of published reports that consolidates and summarizes data for each election cycle. The series consists of studies on: (1) Presidential campaigns, (2) House and Senate campaigns, and (3) PAC's and party committees.
- Computer index 93, a list of Presidential, Senate, and House candidates, provides the name, address, and treasurer of each candidate's committee(s).
- Computer index B, a list of all PAC's and party committees, includes each committee's address, identifies the sponsoring organization of a corporate or labor PAC, and notes whether a committee has qualified as a multicandidate committee.
- The committee/sponsor index lists PAC's alphabetically and provides the names of their sponsoring organizations; the sponsor/committee index lists the sponsoring organizations alphabetically and names their PAC's.

State campaign records offices also carry many of the FEC's free publications, including copies of the Federal Election Campaign Act and FEC regulations. The FEC's "Campaign Guide" series describes the law's requirements for different types of political committees, and a series of brochures addresses specific political activities which come under the law's jurisdiction.[1]

The Federal Election Commission

Located in Washington, DC, the Federal Election Commission can assist you through its toll-free phone line, 800–424–9530.

Call the Commission to order free publications or to place your name on the mailing list of the Commission's monthly newsletter, the "Record." FEC staff can also answer questions you may have on the Federal campaign finance law.

If you want to order copies of campaign finance reports or computer indexes, call the toll-free number and ask for the Public Records Office. This office maintains, for public review, all reports filed by committees and other documents pertaining to the Federal campaign finance law. (There is a charge for duplicating material.)

Reporters with questions on any aspect of Federal campaign finance should call the Press Office, using either the toll-free number or 202–523–4065.

The FEC's National Clearinghouse on Election Administration provides information on the electoral process and publishes reports on election administration. For more information, call the toll-free number and ask for the clearinghouse.

LIST OF STATE OFFICES

The following offices provide direct computer access to FEC campaign finance information. Call, write or visit the office nearest you.

Office of the Secretary of State, State Capitol, Room 103, Montgomery, AL 36130. 205–261–3126.

Office of the Secretary of State, 107 South Broadway, Room 4001, Los Angeles, CA 90012. 213–620–3104.

Office of the Secretary of State, 1230 J Street, Room 219, Sacramento, CA 95814. 916–322–4880.

Office of the Secretary of State, 1560 Broadway, Suite 200, Denver, CO 80202. 303–866–2021.

Office of the Secretary of State, State Capitol, Room 110, Atlanta, GA 30334. 404–656–2871.

Illinois State Board of Elections, 100 West Randolf Street, Suite 14–100, Chicago, IL 60601. 312–917–6440.

[1] See especially the brochure "Using FEC Campaign Finance Information."

Office of the Secretary of State, 1701 McCormack Building, One Ashburton Place, Boston, MA 02108. 617-727-2832.

Office of the Secretary of State, State House, Providence, RI 02903. 401-277-2340.

Washington Public Disclosure Commission, 403 Evergreen Plaza, Olympia, WA 98504. 206-753-1111.

Question. Before we move, I would like to have you briefly describe the move to new quarters. How are things going? Have you had problems? How soon will you be settled?

Answer. The Commission expects to occupy its new quarters by September 30, 1985, as promised by the GSA. The new location is 999 E Street, NW., although we have not received final answers as to the total space to be occupied and the cost of such space as of yet. The Commission is somewhat concerned that the amount of space and the final move date have not been resolved. However, GSA assures us that our move will commence in September 1985. Our original hope had been to complete our move by March 1985.

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

STATEMENT OF ROBERT B. HAWKINS, JR., CHAIRMAN

ACCOMPANIED BY:

F. JOHN SHANNON, EXECUTIVE DIRECTOR

FRANKLIN A. STEINKO, JR., BUDGET AND MANAGEMENT OFFICER

PREPARED STATEMENT

Senator ABDNOR. Next, we are going to hear from Mr. Robert Hawkins, Jr., who is Chairman of the Advisory Commission on Intergovernmental Relations.

Mr. HAWKINS. As you can see, Senator, we are a very small Commission. We only have three people here today.

I would like to thank you for this opportunity to appear before you, Mr. Chairman, Senator Proxmire. On my left is Mr. John Shannon, who recently was named Executive Director of our Commission after 20 years of service with the Commission. And on my right is Mr. Franklin Steinko, who is our budget and management officer.

If there are no objections, I would like my written testimony to be included in the record.

Senator ABDNOR. Without objection, it will be made a part of the record.

[The statement follows:]

STATEMENT OF ROBERT B. HAWKINS, JR.

Thank you, Mr. Chairman. It is a pleasure to be here this morning to discuss the work of the Advisory Commission of Intergovernmental Relations (ACIR). First, let me present to the distinguished chairman and members of the subcommittee the report you asked ACIR to prepare on cigarette bootlegging--Cigarette Tax Evasion: a Second Look; it has just been published. I trust it will meet the needs of the subcommittee, and I will be happy to have ACIR staff provide any additional assistance you may require to follow up on the Commission's findings.

Mr. Chairman, the relations between our federal, state, and local governments are now undergoing a greater change than at any time since the Great Depression and the New Deal.

- For almost 200 years we have operated under the assumption that certain prerogatives of state sovereignty would be constitutionally safeguarded by the Supreme Court. Very recently, a bitterly divided Supreme Court dealt a stunning blow to this doctrine in Garcia vs. San Antonio.

- Since the enactment of the federal individual income tax in 1913, income taxpayers have been allowed the privilege of deducting their state and local taxes when computing their federal tax liability. Now the Treasury proposes to eliminate this deductibility feature.

- Also since 1913, state and local governments have enjoyed great leeway in issuing tax exempt bonds. Now the Treasury proposes to do away with the tax exempt privileges for a wide variety of purposes--economic development, low interest mortgages on owner-occupied housing, student loans, and for private hospital and educational facilities.

- From the end of the Korean War until 1979, federal aid constituted the fastest growing element in state and local budgets. Since 1979, the federal government has been retreating along the entire federal aid front.

These great changes--actual and proposed--are now creating severe tensions for our federal system. During this period of change, our intergovernmental system needs the forum provided by the ACIR where reasonable men and women can work out the necessary accommodations.

Mr. Chairman, the Advisory Commission on Intergovernmental Relations is a unique institution in the American system of federalism. This body--composed of federal, state and local policymakers--is specifically charged by Congress with responsibility to study the workings of American

federalism and to suggest ways to minimize or resolve the inevitable conflicts among governments that arise in our federal system.

Each of the world's major federal systems has established a regular and ongoing process for intergovernmental consultation. In contrast to the other federal systems, however, the United States relies most heavily on ad hoc negotiation and discussion among the different levels of government. Although this ad hoc approach may be sufficient to meet many needs, it is necessary to have an institution that performs the vital function of regular and ongoing intergovernmental consultation. The Advisory Commission on Intergovernmental Relations serves that need for our nation.

In the light of the recent constitutional, fiscal, and political developments cited above, this advisory and consultative function appears to be far more critical now than ever before. For example, the Supreme Court's recent Garcia v. San Antonio decision, overturning almost 200 years of constitutional precedent, means that the court will no longer adjudicate Tenth Amendment challenges to the Commerce Power, thereby leaving these decisions entirely to the political process. Yet, the constitutional structure of federalism envisioned by the framers of the Constitution has been altered drastically over time by changes in the election of senators and presidential electors, and by the declining importance of state-based political parties, as well as by the actions of federal courts. ACIR is well into a study of the state and national political parties, and is just beginning a major study on the role of the national courts in our federal system. These studies are examining precisely the kinds of issues raised by the Garcia decision and other current events.

On the fiscal side, there is an imperative need for policymakers at all levels of government to grapple with two great issues: how to reduce massive federal deficits and reform our badly--many would say fatally--flawed federal income tax. Measures taken at the federal level

to deal with these issues will have far reaching implications for the way states and localities spend, tax and borrow.

Dealing with federal deficits will likely mean a continuing retreat on the federal aid front for the next few years. Overall, the President has proposed cuts in intergovernmental grants amounting to $6.3 billion next year. If one excludes the proposed increases in Medicaid, the cuts amount to $7.6 billion. Included is the elimination of General Revenue Sharing. As usually is the case, the Office of Management and Budget has not provided a state-by-state analysis of these proposed cuts. The ACIR will provide Congress and state-local officials the essential state-by-state information they need to evaluate the full effects of these budget proposals.

But the fiscal evaluation of proposed budget cuts is not the whole story. Although policymakers from all corners of the nations are beginning to realize that some intergovernmental aid reductions will be necessary, they are also coming to the realization that spending reductions are not necessarily incompatible with genuine intergovernmental reforms--indeed reductions and reforms may be complementary. Back in 1983, Congress recognized that pressures for budget cuts could bring with them opportunities for long-needed reforms, and it asked ACIR to assist the U.S. Treasury Department in a major study of federal-state-local fiscal relations. The Commission fully expects to be asked again by the Administration, by members of Congress, and by state and local officials to recommend ways to accompany federal spending reductions with genuine reforms that would send tax sources as well as responsibilities back to the state and local governments. The Commission is ready to meet this challenge and has already laid the foundation for work in this area with its research for the current Treasury study.

Tax reform is the second great fiscal issue faced currently by national, state and local policymakers. To date, one of the overlooked aspects of tax reform is its implications for state-local governments. In December, ACIR published a major report with Commission recommendations

on this matter, entitled Strengthening the Federal Revenue System: Implications for State and Local Taxing and Borrowing. Moreover, the Commission is currently engaged in one of the most important tax studies it has yet undertaken--a state-by-state analysis of the likely effects of five major tax reform proposals. We have been beseiged by calls from state fiscal officers who are struggling to understand what various tax reform proposals mean for their state revenue systems. Treasury has not provided this analysis for the states, leaving ACIR as the only body currently providing the comprehensive analysis that Congress and state and local officials require. Our unique capabilities have been recognized by leading research agencies as well as by state and local officials; the Federal Reserve Bank of New York and the Congressional Budget Office have asked us to share with them the results of our study.

These current issues of critical importance to the health of our federal system of government, and ACIR's timely responses to them, demonstrate anew the wisdom of Congress in establishing ACIR. The Commission often has assisted with such issues in the past. For example, when general revenue sharing was being debated in the 1960s, ACIR helped resolve the tough issue of how to allocate the funds among the states and localities. And as the block grant concept developed during the 1960s and 1970s, ACIR supplied much of the underpinning theory, evaluations of the early programs, and push for additional enactments.

The Commission's congressional members and statutory mandate to serve Congress place ACIR in a unique position to continue assisting Congress and others. I pledge to you our untiring efforts to help resolve the important intergovernmental issues now facing Congress and the nation.

Mr. Chairman, let me conclude by returning to my opening point about the great changes now pressing upon our federal system and creating severe intergovernmental tensions. These acute pressures on all partners in the system would make a strong case for establishing an intergovernmental body like ACIR now if Congress, in its wisdom, had not already created our Commission 25 years ago.

Mr. HAWKINS. Senator Nething was sorry he could not attend today, but he said he had problems in the North Dakota Legislature which he had to take care of.

I would like to give you a very brief introduction and answer three questions that we have been dealing with at the Commission over the last year. Why is an ACIR operation important? What are we going to be doing in the coming year? And how can we improve on our roles?

The Commission was formed 25 years ago under a bipartisan spirit by then President Eisenhower and the Congress to study problems and issues in the Federal system in a bipartisan nature, and to provide the public, the Congress, and State and local leaders with alternatives and well thought-out options on how to make the system work more smoothly.

If there was ever a critical need for ACIR, it is now. Why? I think one merely has to look at the state of the Federal system. The week before last, the Supreme Court, in *Garcia* vs. *San Antonio*, overturned the *Usery* vs. *National League of Cities* decision, which basically has removed any real constitutional constraint or role of the court in being an arbiter in the Federal system.

One of our key roles, one of our missions is to see how we can balance powers in the Federal system to help them work more effectively. The Treasury Department proposal to remove deductability of State and local taxes has certainly gotten the attention of our State and local officials.

More importantly, it removes a source of revenue to State and local communities that was part of the original constitutional bargain in 1913 to bring about the income tax.

Third, decreasing revenues to State and local governments, including the proposal to remove revenue sharing, is again starting to change and alter relationships and forcing us to think in new ways.

Fourth, the gaining interest and momentum for some kind of constitutional solution to the deficit question, if it comes to pass, will clearly change the way our Federal system operates.

The increasing impact of the judiciary both at the State and Federal levels is, some say, negative. But, clearly, to the Advisory Commission, it is an impact that is, again, altering relationships.

Finally, just the sheer increasing complexity of our system requires that we have greater insight into how that system operates.

ACIR RESEARCH AGENDA

Our research agenda, which was just accepted by the Commission at its March 8 meeting, was prepared and headed up by Governor Thornburgh of Pennsylvania and will have us addressing the following issues in the coming year.

First, a major study into the whole question of judicial federalism, first trying to assess what the effect of that intervention is and then, two, trying to propose remedies that have some real chance of solving the problem.

Second, a major study is underway on the effect that fiscal mechanisms and constraints at the State level have had, and if there is any applicability to a Federal constitutional amendment, if such ever came to be.

Third, we are looking at what we call the problems of local governments and how, in a period of retrenchment and decreasing revenues from the Federal and State governments, they can become effective with what I call limited political economies; that is, how can they better generate wealth. If they are not going to get it from the Feds and States, then they had better have a set of policies they can adopt to provide their own levels of services.

Fourth, we are doing a major study which has been funded in part by the Ford Foundation to look at the implications of alternative tax simplification plans on the State and local governments. As you know, there are about four different plans floating around and what we are trying to do is provide the intergovernmental community with some objective information on what the likely impacts are on the Federal Government.

We are also taking a look at alternative service delivery strategies, again trying to see what strategies State and local governments can introduce to try and provide a higher level of services through more effective means.

We are also taking a major look at welfare reform, a project we have been working on with the Treasury Department, to see if we cannot find better ways to streamline the delivery of welfare services through the Federal system.

It is our assumption that we are neither going to decentralize federalism nor nationalize it, so we had better pay some strict attention to how we make it more effective.

Finally, we are undertaking a series of turnback studies, looking at ways in which some programs and tax resources can be turned back to State and local governments. Mr. Chairman, we have had requests from the National League of Cities, the National Conference of State Legislatures, and NACo to undertake this set of studies.

What it is is to see if there are not alternatives to the proposal to merely get rid of revenue sharing, but see if there is not some way to combine a set of programs that meet both the objectives of the President and the Congress and local governments.

ACIR'S ROLE

So as you can see, we have a full agenda for the coming year. We can already hear some of the squawks from different interestgroups on varying issues that we are trying to touch important issues. We will not flinch from doing that, but I think it is important to note—and one of the things I try to do is to drum into our commissioners and the staff why our role is so important.

It seems to me that role is found in the nature of the Federal system. The Founding Fathers contended that the American experiment in self-

governance was predicated on the assumption that citizens and elected officials, through reflection and choice, could create, maintain, and change their governmental institutions.

If they are to make wise decisions and choices, they must have access to critical information that makes us aware of the benefits and liabilities of different alternatives. Our role, then, at ACIR is a Federal one to provide the critical information and assessment, and to stimulate the debate on these issues.

We have done this in a bipartisan way for 25 years, and will continue to do it. It is my judgment that in the next few years, ACIR will play a critical role in shaping our understanding of the forces that are affecting the Federal system and in outlining the possibilities that will ultimately be enacted as solutions.

If the Federal system were static, you would not need us. Unfortunately, or fortunately, it is not static. It is always changing and constantly requiring that we stay on our toes and try to look at some of these old issues in new ways.

As you will notice in our budget request, if there is not a 5-percent pay increase, and the necessary funds are restored, we will take about an 8-percent overall decrease from our budget request. We can live with that. We have had tremendous increases in productivity over the last few years. OMB estimates that we increased our productivity by 27 percent by forcing professionals to finally get in front of a computer rather than giving secretaries rough drafts.

We are in the process of sending our research library, which was miniscule and not used very much to Georgetown.

Mr. SHANNON. George Washington University.

Mr. HAWKINS. George Washington, in return for privileges for our staff to use their library. We are lopping off about 1,000 square feet and giving it back to GSA. So we are taking a number of steps that will allow us, we believe, to live within the cuts and continue our high level of productivity.

Thank you for the opportunity, Mr. Chairman.

I would like to submit for the record the four letters from the associations I previously mentioned into the record.

Senator ABDNOR. We will insert them at this point

[The information follows:]

LETTER FROM DAVID E. NETHING, SENATOR, NORTH DAKOTA SENATE

MARCH 13, 1985.

Hon. JAMES ABDNOR,
U.S. Senator, Hart Senate Office Building, Room 309, Washington, DC

DEAR SENATOR: On March 19, 1985, your subcommittee on appropriations will review the budget of the Advisory Commission on Intergovernmental Relations. For the last 3 years, I have been a member of ACIR. This is one Federal agency that is worth every dollar it spends. Let me point out a few of the valuable contributions that ACIR makes to our understanding and improvement of the Federal system:

1. Its studies and recommendations were the foundation pieces for general revenue sharing, block grants, and President Reagan's federalism reform proposals in 1982.

2. At our March 8, 1985, commission meeting we adopted a set of research topics that again will provide Congress and State-local officials with objective information and well thought out alternatives for reallocating programs and revenues back to State-local governments, a review of Federal tax reform proposals and the implications of judicial federalism. These studies are but few of the important topics that we will address in the coming year.

3. ACIR is also an important place where local, State, and Federal officials can learn and work on a personal basis on ways to improve intergovernmental relations.

Within the week, National Conference of State Legislatures [NCSL] will ask ACIR to undertake an important study on alternative approaches for sending programs and tax resources back to State and local governments. We do this because we can count on ACIR's objectivity.

Under the leadership of Bob Hawkins, ACIR is again a first class research agency. We clearly get our moneys worth and I hope you will look favorably upon their reauthorization.

Sincerely,

DAVID E. NETHING.

LETTER FROM PHILIP B. ELFSTROM, PRESIDENT, NATIONAL ASSOCIATION OF COUNTIES

MARCH 14, 1985.

Hon. ROBERT B. HAWKINS, JR.,
Chairman, Advisory Commission on Intergovernmental Relations, 1111 20th Street NW., Washington, DC

DEAR CHAIRMAN HAWKINS: The purpose of this letter is to request that ACIR develop alternatives to the State and local Federal aid reductions proposed in President Reagan's 1986 budget.

We have recognized that there is a clear need to reduce budget deficits and this in turn will require the Federal Government to scale back its aid to State and local governments. Progress on the deficit reduction, however, should be accompanied by an examination of various ways that local governments and States can be given more flexibility to compensate for fewer aid dollars. To be more specific, the ACIR should give serious consideration to a study on turnbacks—both tax sources and program responsibility—as a way of reconciling the Federal need to meet its budget deficit reduction objectives in the Federal aid area while at the same time insuring more fiscal leeway for counties, cities, and States.

ACIR is a unique position to examine these options in light of your bipartisan nature, your reputation for solid, unbiased research and your knowledge of State and local finances. Such an effort would also seem to be closely related to your past and present research on tax turnbacks.

ACIR can make a valuable contribution to the budget reduction debate and NACo hopes you will be willing to undertake this urgent effort.

Sincerely,

PHILIP B. ELFSTROM.
President.

LETTER FROM JOHN T. BRAGG, DEPUTY SPEAKER, HOUSE OF REPRESENTATIVES, STATE OF TENNESSEE; PRESIDENT, NATIONAL CONFERENCE ON STATE LEGISLATURES

MARCH 19, 1985.

Hon. ROBERT B. HAWKINS, JR.,
Chairman, Advisory Commission on Intergovernmental Relations, 1111 20th Street NW., Washington, DC

DEAR CHAIRMAN HAWKINS: Driven by the need to reduce budget deficits, the Federal Government is being forced to reduce its aid outlays to States and localities. The critical question for our Federal system is this—how can we balance or reconcile the

Federal need to trim back aid to States and localities with the State and local interest in gaining more fiscal flexibility as compensation for fewer Federal aid dollars:

The National Conference of State Legislatures requests the ACIR to examine this issue and lay out alternative plans for balancing these conflicting Federal and State-local interests. Because the ACIR staff is now conducting a turnback study for the Treasury, the Advisory Commission should be in a good position to lay out alternative plans in a relatively short period of time.

There is added reason for this request: the presence of Federal, State, and local members on the Commission will assure balanced assessment of this difficult issue.

Sincerely,

JOHN T. BRAGG.
Deputy Speaker, Tennessee House of Representatives, President, NCSL.

LETTER FROM ALAN BEALS, EXECUTIVE DIRECTOR, NATIONAL LEAGUE OF CITIES

MARCH 18, 1985.

Hon. ROBERT B. HAWKINS, JR.,
Chairman, Advisory Commission on Intergovernmental Relations, 1111 20th Street NW., Washington, DC

DEAR CHAIRMAN HAWKINS: The National League of Cities is deeply concerned about the impact on our Nation's cities of the deep cuts in Federal aid programs proposed in the 1986 budget. The budget makes particularly severe reductions or eliminates entirely several programs of vital importance to cities: General revenue sharing, the community development block grant, urgan mass transit grants, and the urban development action grants

While we are very much aware of the need to reduce the Federal deficit and the President's commitment to reach this goal by reducing expenditures, we believe that there are ways in which deficit reduction progress can be made in a way that would also provide cities greater fiscal flexibility. To be more specific, we believe that the Commission should explore a wide variety of alternatives that have for their central objective, providing local governments and States greater fiscal leeway as compensation for any reduction in Federal aid flows. This effort could involve the feasibility of turning back tax sources to cities, counties, and States to offset the revenue loss caused by the elimination of narrow categorical aid programs. In addition, we would hope that the ACIR would continue to explore the possibilities of achieving additional economies in the grant-in-aid programs by continuing to substitute block grants for the many categorical aid programs still in existence.

Because of the Commission's unique composition—policemakers from all three levels—it is the logical agency to prepare an informational report on this urgent issue.

Sincerely yours,

ALAN BEALS.
Executive director.

COMMISSION MEMBERSHIP LIST

Senator ABDNOR. Well, thank you, Mr. Hawkins. That was a very fine statement. Could you give us a listing for the record of your 26 members of the Commission?

Mr. HAWKINS. Yes; we will do that.

[The information follows:]

MEMBERSHIP LIST

	Appointment date	Expiration date
Private citizens:		
James S. Dwight, Jr., Washington, DC (Republican)	Mar. 7, 1983	Mar. 6, 1985
Robert B. Hawkins, Jr., chairman, Sacramento, CA (Republican)	Sept. 22, 1983	Sept. 21, 1985
Kathleen Teague, Washington, DC (Republican)	Sept. 22, 1983	Sept. 21, 1985
Members of the U.S. Senate:		
David Durengerger, Minnesota (Republican)	Feb. 28, 1983	Feb. 27, 1985
William V. Roth, Delaware (Republican)	Feb. 28, 1983	Feb. 27, 1985
James R. Sasser, Tennessee (Democrat)	Mar. 23, 1981	Mar. 22, 1983
Members of the U.S. House of Representatives:		
Barney Frank, Massachusetts (Democrat)	Mar. 3, 1983	Mar. 2, 1985
Robert S. Walker, Pennsylvania (Republican)	Mar. 3, 1983	Mar. 2, 1985
Theodore S. Weiss, New York (Democrat)	Mar. 3, 1983	Mar. 2, 1985
Officers of the executive branch, Federal Government:		
Lee L. Verstandig, Assistant to the President for Intergovernmental Affairs (Republican)	Sept. 22, 1983	Sept. 21, 1985
Vacancy.		
Vacancy.		
Governors:		
John H. Sununu, vice chairman, New Hampsire (Republican)	Sept. 7, 1984	Sept. 6, 1986
Richard L. Thornburgh, Pennsylvania (Republican)	Jun. 10, 1983	Jun. 9, 1985
Vacancy.		
Vacancy.		
Mayors:		
Ferd Harrison, Scotland Neck, NC (Democrat)	Jun. 10, 1983	Jun. 9, 1985
William H. Hudnut, III, Indianapolis, IN (Republican)	Sept. 7, 1984	Sept. 6, 1986
Robert Martinez, Tampa, FL (Republican)	Sept. 7, 1984	Sept. 6, 1986
Joseph P. Riley, Jr., Charleston, SC (Democrat)	Jan. 16, 1985	Jan. 15, 1987
State legislators:		
David E. Nething, majority leader, North Dakota State Senate (Republican)	Jan. 16, 1985	Jan. 15, 1987
William F. Passannante, speaker pro tem., New York State Assembly (Democrat)	Jun. 10, 1983	Jun. 9, 1985
Vacancy.		
Elected county officials:		
Gilbert Barrett, chairman of the board, Dougherty County, GA (Democrat)	Nov. 24, 1982	Nov. 23, 1984
Sandra R. Smoley, supervisor, Sacramento County, CA (Republican)	Sept. 22, 1983	Sept. 21, 1985
Vacancy.		

ACIR'S IMPACT

Senator ABDNOR. Over the years, the studies, findings, and recommendations you make—what kind of a batting average do you have with States and other levels of government? Do they buy them or do you have to go out and sell them when they are done?

Mr. HAWKINS. I think we have had a fairly good record. In fact, I once heard a story that some State enacted our model legislation and even said model ACIR legislation. So they take our findings quite literally.

On the national level, we have had, I think, a fairly high batting average. We played two important roles, for example, in revenue sharing. We did a lot of the original design and thought on that, and we al-

so acted as a forum and a body where State and local leaders and Federal leaders could come together and discuss these issues in ways that were less heated and hopefully more enlightening than when they get up here.

Most of our work was behind the block grant proposals, both in the Nixon administration and in the Reagan administration. The White House relied heavily on our research on their 1982 initiatives, and a lot of our recommendations have been enacted at the State and local levels.

Senator ABDNOR. When one State does it, do the others usually follow?

Mr. HAWKINS. Yes; one of the problems that we have had, and I think we have finally solved this issue, is given the fact that we are a research institute and we do not have a large budget, how effective can you be in implementation? We cannot have people out traveling around the country all the time.

So we have changed our implementation section to a communication and publication section, in which we are going to try and get broader dissemination of our information. We work with the Council of State Governments as our main body that takes our work and translates it into model legislation and then gets it out to the State legislatures.

By having members of NCSL on our Commission, a lot of our work goes right through them into the State legislative process.

Senator ABDNOR. Do you get a lot of questions from the States that cause you to go into these studies? Do they ask you to do certain studies?

Mr. HAWKINS. We have a formal process by which we adopt our research agenda. This year, we held six regional meetings throughout the United States where we heard testimony from over 150 individuals.

One of the things I have been trying to do is to get our Commission meeting outside of Washington two times a year because, one, you get a little different perspective on things. We get better representation from our Federal members when it is out of town.

The other thing is to get the views of the average citizen who is having to deal with this complex Federal system.

PROPERTY TAX CIRCUIT-BREAKER

Mr. SHANNON. Mr. Chairman, as an example of how we try to move reforms along, back in the middle 1960's the State of Wisconsin pioneered with a very new and much more sophisticated Property Tax Relief Program. We call it the circuit-breaker.

If the property tax load exceeds *x* percent of a family's income, the amount in excess is deemed to be extraordinary and refundable to the homeowner. Our Commission looked at that Wisconsin experiment and, after some study, put its seal of good housekeeping on it.

Then we developed model legislation patterned very closely after the Wisconsin model. Now, there are about 30 States in the Union that now provide property tax homestead relief for low-income families that is modeled on the Wisconsin plan.

So one of our major objectives is to—the Federal system is supposed to be, as the English would say, a laboratory where you see a good idea in one State; you pick it up and move it along to others. And that Wisconsin experiment of the circuit-breaker on the property tax relief front has been one of our best examples.

Senator ABDNOR. That is very interesting.

Senator PROXMIRE. You sure picked the right State for the example. [Laughter.]

You could have done better if you had picked South Dakota.

Senator ABDNOR. Yes. [Laughter.]

Mr. SHANNON. It happens to be my State. I grew up in Kenosha.

Senator PROXMIRE. Is that right?

Mr. SHANNON. Yes.

Senator PROXMIRE. Orson Welles also grew up in Kenosha.

Mr. SHANNON. Yes; he did. I heard all kinds of stories about Orson Welles.

FUNDING THE COMMISSION

Senator PROXMIRE. You look like you are in better shape than he is.

You are requesting an appropriation of $2,058,000 next year, a reduction of about $83,000 below last year's appropriation level of $2,131,000. Then, of course, if you allow for the fact that we expect about a 4-percent inflation, in real terms you are about $160,000 less than you were last year.

You indicate that this year, with the cuts in Federal assistance for a whole variety of programs—not only in revenue sharing, but in many, many other programs where the Federal Government has assisted the States—and possibly tax reforms, we will have greater problems than ever.

Now, I understand you also receive contributions from other sources, about $120,000 from the States.

Mr. HAWKINS. Correct.

Senator PROXMIRE. That is a small part of your budget. What other sources of income does the Commission have in addition to that State contribution, and what, if any, do you expect to receive next year on top of your direct appropriations?

Mr. HAWKINS. Well, we are trying to increase the level that we get from States. Quite frankly, the problem there, Senator Proxmire, is that every once in a while a Governor will read one of our reports and say, I will be damned if I am giving that Commission any more money, and we will get scratched off the list.

We are willing to live with that, but we hope to increase that up to the $150,000 range. We get some money off publications, not a lot. We have just received $50,000 from the Ford Foundation to conduct this study on the effects of alternative tax simplification programs.

We have several scholars. One of the ways we reduce our costs is to try and get good scholars to come in on sabbatical so we can pick up one-half their salary and get somebody that would ordinarily cost

$60,000 and we can pay them $30,000. We are going to try and pick up some fellowship money from foundations from them.

Then we hope to increase our discretionary money by cutting back further on unnecessary expenditures at the Commission.

Senator PROXMIRE. What so-called unnecessary expenditures would you cut back?

Mr. HAWKINS. Well, we have got more space now. We are cutting our space back. We are getting rid of our library, and that is going to save us money.

Lin, what are the other areas?

Mr. STEINKO. The Treasury Department is funding part of the tax studies that are going on. We expect the Justice Department to work on the judicial reform project, so that other Federal agencies do help us in the funding.

Space is one thing, if we can work it out with GSA, that we will return, which should have an impact on late 1986 and early 1987. There has to be some construction to allow for the space to be dropped off.

Also, if you will notice the current 113's that are being filed, the overall grade for the agency is slowly trending downward.

Senator PROXMIRE. The overall what?

Mr. STEINKO. Grade level.

Senator PROXMIRE. Oh, I see; the level of pay, therefore.

Mr. STEINKO. Correct. Also, employees are being hired more to the project they are working on than to a full-time commitment. In other words, a specialist is brought in to work on a given project. They are employed for the period of time that the project is going on.

These are all places where we hope to save money.

Mr. HAWKINS. One of the things we have done, Senator, when I took over several years ago was to institute agreements of employment so that we hired people not for life, but for 3 to 5 years to give them protection, but on the other hand with a set of clear expectations that if they did not perform, they would no longer be there.

It seemed to me at that time that especially in a research operation, you have got to have new blood flowing through the place, and there are two ways to do that. One is to keep people on their toes and, two, to bring new blood in. Lots of times, we find that by having a smaller core of long-term people and bringing in new blood every year, we get higher productivity, it costs us less, and we can be more responsive to our commissioners.

ELIMINATING GENERAL REVENUE SHARING

Senator PROXMIRE. Have you done any recent analysis on what the impact of the elimination of revenue sharing would have on local governments and, of course, indirectly on State governments because they presumably have to pick up some of the slack, or would feel they would have to do so? Any studies to show what effect that would be?

Mr. HAWKINS. This is Mr. Revenue Sharing here. I will let him answer that.

Mr. SHANNON. We just signed a contract today that would give us on a State-by-State basis the implications of the cutbacks not only on general revenue sharing, but throughout the entire Federal aid system that no one has been able to put their hands on up to now.

We have seen national figures and we have seen some very——

Senator PROXMIRE. It will be fascinating for us in the Congress.

Mr. SHANNON. Yes; and we think in the Federal system you have got to break those national figures down into State-by-State, and in many cases we will also be able to get metropolitan figures, but at least as an irreducible minimum State-by-State for fiscal 1985 and projected 1986 figures, so that you get a comparison.

The same thing with our Federal tax study; we will take the Treasury proposal, the Bradley-Gephardt, the Kemp-Kasten, and so on, and run them through State by State so people can see at that level what the implications are, and there are going to be different regional effects; there is no question about it.

Mr. STEINKO. I would like to make a comment on this. The Hill has seemed to have liked some of our staff. You will have both in the House Budget Office and the Senate Budget Office one of our staff members by the end of this year. Therefore, the data that we are asking for from contractors will be compatible with the Senate and the House computer systems, so you can manipulate the data.

Senator PROXMIRE. I like the last part of it. [Laughter.]

That is very encouraging. At any rate, your answer is that as far as revenue sharing is concerned, we will be able to have the data?

Mr. SHANNON. Yes; you will see not only revenue sharing and its effects, but——

Senator PROXMIRE. This will give us total amounts, but I am wondering, if and when we do cut it out—I am frankly in favor of abolishing revenue sharing because I just do not think we have the revenue to share. I wish we did, but we do not. But I think we ought to know what we are doing when we do it.

Mr. SHANNON. Yes; on a disagregated basis.

Senator PROXMIRE. Very good. Thank you, Mr. Chairman.

Senator ABDNOR. Well, thank you, Senator Proxmire.

ADDITIONAL COMMITTEE QUESTIONS

Again, there are other questions for the record we will submit because we have a number of agencies yet to go.

We thank you for very worthwhile, fine testimony and we wish you well.

Mr. HAWKINS. Thank you, Senator.

Senator PROXMIRE. Mr. Chairman, I am going to have to leave, unfortunately. I have an appointment that I have to keep. I am sorry I do because I wanted to hear these next agencies, but I do have some questions for the record.

Senator ABDNOR. Fine. We wish you could stay. I, too, have some appointments that have to go by the wayside.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. Funding requests for the printing and reproduction, other services, and supplies and materials accounts were reduced significantly in fiscal year 1985 and are to remain constant in fiscal year 1986. How has this impacted the Commission? What was done to accomplish these reductions?

Answer. It is our hope, and I underline hope, that what was projected in the budget request holds true. Over the past several years, ACIR operations have been altered in response to various internal and external initiatives and incentives, most of these pertaining to cost increases within the Federal establishment and technological advances in the private sector.

First, the cost of paper and computer supplies are falling as competition increases and it is hoped this trend will continue into fiscal year 1986.

Second, with regard to printing and reproduction, the size of individual publications, the total number of publications, and the quantity of each publication printed will be reduced both as an economy move and in response to a shift in the way the Commission plans to disseminate its findings and recommendations.

Finally, the other services category is a tidal pool that fills or empties depending upon the number of reports that are approved for printing by the Commission. The figures for fiscal year 1985 and fiscal year 1986 are based on an average.

Question. State and local governments contribute to the Commission. You have set a goal of $120,000 for 1986. How will you get the money? Solicitation? Voluntary contributions?

Answer. Each year the Commission solicits voluntary contributions from all 50 States. The response over that last 3 years has been encouraging and the goal of $120,000 in contributions and honorariums has been set for 1986. We hope that the goal can be achieved.

The findings and recommendations of the Commission influenced the level of State contributions. To be more specific, when ACIR displeases the majority of States—their contributions decrease, but when it pleases the majority we see an increase. For example, when ACIR recommended no increase in the Federal in-lieu payment on western lands, several Governors decided that a contribution to ACIR was not a necessary expense.

Question. I note the trust fund obligations are to be reduced significantly in 1986. To what changes will the reductions be attributed?

Answer. About 5 years ago the Department of Defense, Office of Dependent Schools, asked if they could use ACIR's data base on a reimbursable, time sharing basis. It was approved and the initial use was small. Over the years the activity increased to the point where the House Committee on Government Operations, Subcommittee on Intergovernmental Relations, felt a material distortion of ACIR accounts had taken place and asked ACIR to terminate the agreement. The agreement was terminated in December 1984. This one change accounts for the reduction in trust fund obligations.

Question. Reimbursables are important to the Commission. Do agencies seek assistance from the Commission on these actions?

Answer. Reimbursables are important to the Commission, but we never will let the tail wag the dog. We will never let contract, that is, reimbursable work, affect our regular activities except in a positive manner.

Reimbursables constitute a two-way street. First, another agency may request ACIR to undertake research for any number of reasons. If the Commission approves, a contract is signed and the agency reimburses ACIR for the work performed and costs incurred. Going the other way, the Commission may ask the staff to do a study that current budget restraints make impossible to fund. In this case, ACIR will solicit funds from private, nonprofit foundations or other Federal agencies.

Question. If the 5-percent cut is not approved, but no funding is provided for the differences, how will the Commission be affected?

Answer. We have been forecasting for just such a situation. This is part of the reason we have been working on reducing office space, rethinking both the library and duplicating shop, and analyzing our employment practices. Even if we implement all of the reductions and refinements we have considered, in all likelihood we will be fiscally unable to fund three staff positions. This staff reduction, in turn, would result either in a reduced workload or a stretched out Research Program.

U.S. MERIT SYSTEMS PROTECTION BOARD

STATEMENT OF HERBERT E. ELLINGWOOD, CHAIRMAN

ACCOMPANIED BY:

DENNIS M. DEVANEY, BOARD MEMBER
RICHARD REDENIUS, MANAGING DIRECTOR

PREPARED STATEMENT

Senator ABDNOR. Our next witness will be Mr. Herbert Ellingwood, who is Chairman of the U.S. Merit Systems Protection Board.

It is good to have you again with us, Mr. Chairman. Again, I am sure you have been around here enough to know that you may proceed in any manner you wish to. Introduce your people and submit your statement for the record and proceed.

Mr. ELLINGWOOD. Thank you, Mr. Chairman. I have with me today, Mr. Dennis Devaney, a Board member, and Mr. Richard Redenius, who is our Managing Director, and some of the staff.

Senator ABDNOR. Fine.

Mr. ELLINGWOOD. Thank you for the opportunity to come before you on the MSPB's appropriations for 1986. I will submit my written testimony for the record, with your permission, and then summarize where we are.

Senator ABDNOR. Without objection, we sure will.

[The statement follows:]

STATEMENT OF HERBERT E. ELLINGWOOD

I welcome the opportunity to meet with the Subcommittee to discuss the Merit Systems Protection Board's appropriations request for Fiscal Year 1986.

Last year, I was able to make the prediction that Fiscal Year 1985 would be a relatively normal workyear. So far, that prediction has come true.

Through reliance on an ongoing strategic planning effort, the Board, in 1984, examined all procedures critical to its primary functions. The purpose of the review was to ensure not only the efficient use of our resources on a daily operational basis, but also the establishment of a management framework which will be durable and practical in the years ahead. Central to this review was our steadfast commitment to the stewardship of the merit systems.

It is a goal of this Board to be a model judicial agency in all aspects of its operations. In this regard, our strategic planning committee established a comprehensive syllabus for hearing-management training for presiding officials, monitored the development of a fully integrated information and case tracking system and the development of a legal research and reporting system, and recommended increased delegation of fiscal and administrative authority to office heads.

Further, as a cost effective measure, the Board expects to reduce its total office space by approximately 20,000 square feet by the end of this fiscal year.

In addition, the Board reorganized the Office of the Clerk and developed enhanced case management techniques to ensure control and integrity of the appellate case system.

The Board also established a timely adjudicative schedule in the regional offices and in Headquarters, thereby achieving timely processing in all routine appeals consistent with our statutory mandate.

We have proposed also to expand and extend the Board's voluntary expedited appeals procedure based on program evaluation results. This procedure allows for the vigorous involvement of presiding officials in the resolution of non-precedential appeals and for adjudication in less than half the time of our formal appeals procedure.

These initiatives have resulted in a strengthening of the Board's ability to carry out its statutory functions in a manner consistent with the highest traditions of the civil service. We look upon our achievements with great pride as we strive to support the vitality of the civil service merit systems.

Fiscal Year 1986 Request

Mr. Chairman, the Board, with OMB's approval, is requesting a total of $20,349,000 and 374 workyears for our FY'86 appropriation. This funding level is $322,000 and 6 FTEs fewer than our fiscal 1985 request, including the pending supplemental of $194,000, to cover the January 1985 pay raise.

The FTE level provides staffing needed to process the number of cases expected in 1986 and to perform other essential functions. This FTE will allow us to continue strengthening, streamlining and improving the overall management of the Board.

Major management improvements have been implemented, and others will soon be initiated, to make the Board a more efficient and effective judicial agency. The Board's computerized case tracking system has been put in place throughout the agency and serves as a major tool in ensuring that all cases are accounted for and processed within established time limits. This system will be expanded to track action on cases in the Federal courts where Board decisions are challenged or where the Board otherwise has an interest.

The Voluntary Expedited Appeals Procedure is designed to expedite processing of routine non-precedential cases where both parties are prepared to use a less formal process. Under this system, cases are processed within 60 rather than 120 days. Out of the 180 cases processed so far, twice as many settlement agreements have been reached than in our formal appeals process. This program has been tested successfully in six regional offices and is being expanded to all 11 offices.

On October 1, 1984, the Board converted its personnel action processing, administrative payments, payroll, payroll accounting and general ledger accounting to the Department of Agriculture's system at the National Finance Center in New Orleans. This system provides timely, detailed personnel action processing and accounting reports which assist in more efficient management of Board resources. Additionally, a work measurement system has been implemented as a part of the conversion to the National Finance Center. This system provides managers with detailed information on how staff time is being used which aids in establishing performance and productivity standards.

These management initiatives have helped to improve the efficiency and effectiveness of each office of the Board. At this time, I would like to describe the way in which the staffing levels would be divided among our primary functions in FY'86.

Our adjudication process begins when an appeal is filed in the appropriate regional office where an initial decision is issued. This activity requires 171 of our total FTE request, which is a reduction of four from FY'85.

The next phase of the adjudication takes place primarily in the Office of Appeals Counsel. This office is responsible for analyzing petitions for review which may be filed from initial decisions, drafting necessary memoranda or opinions, and recommending decisions to the Board. Our FY'86 FTE request of 43 represents no increase above our FY'85 request.

The Office of General Counsel conducts or monitors all Board litigation and provides legal advice to the Board Members and office directors. This office will maintain its FTE level of 34 in FY'86.

The Case Decision Program Review activity provides for implementation of the Board's statutory mandates and the overall management and administration of the Board's affairs, both in Headquarters and in regional operations. Ninety-eight FTEs are requested for this activity in FY'86. This request reflects a decrease of two FTEs from FY'85.

The Office of Merit Systems Review and Studies is responsible for conducting special studies on personnel issues to determine whether the civil service is free from prohibited personnel practices. In addition, the office annually reviews and reports on significant actions of the Office of Personnel Management. This activity represents 20 FTEs, which is the same staffing level as in FY'85.

Mr. Chairman, that concludes my statement. I will be pleased to answer any questions the Subcommittee may have.

WORKLOAD COMMENT

Mr. ELLINGWOOD. Last year, I began by stating that 1985 should be our first normal year in the life of this particular agency, and so far that is true. Consequently, we were current at every level of our operation by January of this year. I need not remind you that that is a very rare occurrence for any judicial agency.

For example, we figured that the number of cases per Board member, if we ever went through all the numbers in the pipeline—would need to be an average caseload at any one time of 175 cases. The Board members throughout the 3 months of January, February, and March, have averaged about 125 cases. So we are 50 cases below what would be a normal workload.

That is because the Board members have been working extremely hard, as have the staff. For example, in the regions over this last year we have completed approximately 90 percent of our cases in less than 90 days when 120 days is the usual timeframe for completion of a case.

So whether it is in the regions or at the headquarters, people have been working very hard and, as a consequence, we are current. That gives us time for management reform and for fine tuning, which is discussed in our written testimony.

EXPEDITED APPEALS

One of our experimental programs, which is the voluntary expedited appeals procedure, where both parties consent to a more simplified process, cutting the time in half—we have noticed an extra, unexpected benefit which has surfaced.

Now, we find twice as many settlements in these cases as before, which is good for the agency and good for the employee. It shows that both parties are trying to work out their problems without coming to MSPB.

Senator ABDNOR. What is the main reason for that?

Mr. ELLINGWOOD. In the usual judicial process it is kind of a hardened process by the time the individual gets to the court, as it were. So there is less discussion among the parties. There is no involvement by the Merit Systems Protection Board presiding official.

So it seems to go right on through the trial until there is an official result. With the expedited process, there is participation by the presiding officials, and it forces the parties to get together early to see if there cannot be some sort of a compromise worked out.

Senator ABDNOR. Does it work out?

Mr. ELLINGWOOD. It works out, so we have twice as many settlements. So that experiment is now completed and we are putting that into effect across the entire United States, so we think that will be very good.

Senator ABDNOR. Good.

Mr. ELLINGWOOD. We have done a lot of other things like that and we are proud of our accomplishments, and we would be glad to discuss any of those management areas that you would like to talk about today.

BUDGET REQUEST

Our request is for $20,349,000 and 374 FTE, which is less than last year both in money and in FTE. This is less in money by $322,000 and less in FTE by six. But we believe that we can accomplish our job doing more with less, and my staff and I are here for your questions this morning.

Senator ABDNOR. Thank you, Mr. Chairman. All our boards and commissions we have before us—it seems they are doing outstanding work trying to get by on a limited budget. We commend you for the progress you have made to reach the point where you are at now.

STAFF REDUCTION

The Board projects a reduction of six FTE in fiscal year 1986. Where will these spots come from? Are they going to be difficult for you to make?

Mr. ELLINGWOOD. Well, we do not think they will be difficult. I will let Mr. Redenius, who is our managing director, talk about the specific FTE request.

Mr. REDENIUS. Four of the FTE reductions will come from our regional offices and two from units in headquarters. We have found that since the air traffic controller problem 2 years ago, we have been able to systemically, over the 2-year period, reduce the size of our regions.

At one point, we had as many as 435 people in the agency, over one-half of whom were in our regional offices. That number came down in the past year to 380, and we project that we can come on further down to a level of 374. Of that 374, about one-half will be still in our regional offices.

FUNDING REQUEST

Senator ABDNOR. Fine. Do these reductions account for the funding decreases that may be attributed solely to the 5-percent pay reduction?

Mr. REDENIUS. As other agencies have indicated that have appeared before the committee, the pay reduction has been built into our request. If the pay cut were not to go into effect, we would be short by $558,000. In effect, the pay cut more than accounts for the net decrease.

We have also a number of small offsetting increases and decreases which bring us to a net $322,000 reduction.

Senator ABDNOR. We are all sitting around wondering what will be the answer there, I guess, until some action is taken.

PROCEDURE FOR HANDLING A CASE

Now that you have this all set up and in place, why not describe to us how a case makes its way through the system and how it is working out? I would be interested to know.

Mr. ELLINGWOOD. Certainly. Let us take a secretary who feels it is time for her within-grade increase and she is denied her within-grade increase. She processes that through her office and the agency and the agency head responsible decides not to grant her within-grade increase.

At that point in time, she has the opportunity to file an appeal, so she does. It then is filed in the local office in one of our regions or somewhere else in the world. At that moment in time, she is given notice to choose whether or not she wants to file and go the formal route—the judicial route—or the expedited route.

If she decides to go the expedited route, which cuts the time in half, then the agency is asked to go along with it. The agency can choose not to, at which point in time it knocks the case back into the judicial route.

Either way, then, it comes to the process where our presiding official is involved. If it is the expedited route, then the presiding official has some ways to get the parties together and try to work it out so that the case is refined to its bare essentials and there is a possibility of a settlement.

If it is going to go to a hearing, then a time is set for the hearing. We have set artificially a 120-day time limit from the time of the filing until the time that there is a decision and a written opinion by the presiding official.

At that point in time, either party has 35 days to file an appeal with our headquarters office. If there is no appeal, it is a final decision.

Senator ABDNOR. Do you get many appeals?

Mr. ELLINGWOOD. Oh, yes; about 30 percent of the regional cases come to headquarters on appeal. So when it comes up for the appeal, we have an artificial timing again of 110 days from the time that it reaches the headquarters office until it works its way through our appellate levels and through the Board members. So that is the process.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. It is amazing how well you do to move things along. Gentlemen, I tell you, we have a number of other questions, but I have some more witnesses here. We would just as soon have the questions in writing.

Mr. ELLINGWOOD. We would be happy to do that, Mr. Chairman.

Senator ABDNOR. Well, thank you, all of you gentlemen, for coming. You have a fine report. It is very encouraging to see how well you keep operating.

Mr. ELLINGWOOD. Thank you, Mr. Chairman.

[The following questions were not asked at the hearing but were submitted to the Board for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. The Board's personnel and payroll is being handled by the Department of Agriculture for the first time. How are things going?

Answer. We are the first outside user of the personnel and payroll part of the National Finance Center [NFC] system. The system is designed to serve the Department of Agriculture and the processes are tailored to the provisions of that Department's in-house policies. Some processes are being modified to accommodate our needs.

The conversion to NFC was smooth with few problems. Most were data entry errors which were resolved. Problems that are encountered are expeditiously addressed and NFC seems particularly willing to work with us toward resolution.

Question. The case backlog has been virtually eliminated. I congratulate you and your people on a job well done. What are your projections for the future about caseloads?

Answer. Thank you. We are very proud of our accomplishments. For fiscal year 1986, we have projected receipts of approximately 8,200 cases in the regional offices and 2,300 petitions for review in headquarters. Let me describe our record of timely processing to date.

BOARD OFFICES

As of March 19, 1985, there were 125 cases in the Board's offices.

During calendar year 1984, each of the three Board members decided more than 300 cases per month.

The average time for case decision has been approximately 14 days since the beginning of 1984. Headquarters is now deciding approximately 90 percent of its active petitions for review within 110 days.

OFFICE OF APPEALS COUNSEL

As of March 19, 1985, the Office of Appeals Counsel had 341 active pending petitions for review. Approximately 99 percent of this workload, or 335 cases, have been pending for less than 50 days.

Since December 1, 1984, the Office of Appeals Counsel has handled over 95 percent of its cases within 50 days.

OFFICE OF THE CLERK

This office is similar to a court clerk's office. This office certifies 95 percent of its cases in a timely fashion, and has no backlog.

REGIONAL OPERATIONS

As of March 19, 1985, the regional offices had an active pending caseload of 1,872 cases.

There is no backlog in the regions. Approximately 90 percent of the initial decisions have been issued in less than 90 days. As this fact indicates, the regional offices consistently issue decisions well in advance of the established 120-day time standard.

Question. The Board is using credit cards for travel. Have you had time to evaluate how the new travel procedure is working?

Answer. The Board has participated in the Governmentwide travel card procedure for about 6 months and has issued approximately 175 Diners Club credit cards. This procedure is generally working well.

The MSPB traveler receives most of the conveniences and benefits available to personal credit card holders. The Treasury retains use of approximately 60 percent of anticipated subsistence expenses of about 1 month, while the remainder of projected expenses is normally advanced to the traveler to cover incidental costs such as taxi or bus fares, and meals at restaurants not accepting the Diners Club card.

Although there is a modest savings to the Treasury because cash outlays are deferred, the program does not result in any direct budgetary cost savings to the Board. The process is, however, more convenient and easier for the Board to manage.

Question. The 5-percent pay reduction totals $558,000. What would happen to the Board if the reduction was not approved but no additional funding was made available?

Answer. Because we are a personnel-intensive agency which spends 70 percent of its budget on salary and related expenses, the Board has very little flexibility. Without additional funds, we would be forced to reduce staff which would cause a corresponding and immediate buildup of backlog cases and probably delay the issuance of decisions on a timely basis.

Question. Could you outline the case tracking system?

Answer. The Board's case tracking system, which was developed largely in-house, was phased in over a 2-year period. In July 1984, the system was implemented Boardwide.

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Tracking starts with receipt of an appeal in a regional office. Record of receipt must be entered into the case tracking system within 2 work days. Data is entered into an on-line data base via telecommunications. Data concerning receipt of petitions for review of initial decisions in headquarters must also be entered into the system within 2 work days.

All relevant information concerning an appeal is captured: its type; to whom it has been assigned; the date it was filed; the date of hearing; and the date and result of any decisions. At any given time, the Board is able to determine which office is working on a specific case. Because management also uses information provided by the case tracking system for evaluation, office managers enter required information into the system on a timely and accurate basis.

The system issues regular reports to each regional director and headquarters. The reports provide detail and summary information concerning all cases.

This timely collection of information provides management with many more options in coping with the Board's workload. It allows managers to see potential problems before they develop, such as cases approaching the 120-day time limit for issuance of a decision. In 1984, 99 percent of all appeals filed were decided within 120 days.

In addition, the information in the case tracking system is helpful in monitoring the workload of the Board's attorney-examiners. Knowing how many appeals a given attorney has handled, what type they were, and how long it took that official to handle the appeals provides valuable information to managers concerning the Board's workload.

Question. Do you have plans to upgrade your automated data processing system?

Answer. Yes; we are currently considering a number of proposals that were submitted in response to an RFP (request for proposals) issued last fall. We expect that the accepted propoosal will improve the timeliness, usefulness, and efficiency of the system.

To the degree that the costs associated with the RFP are unknown at this time, we may need to augment our funding for fiscal year 1986.

Question. A large percentage of the Board's personnel fall into the grades GS–11 through GS–15. Has the OPM Reduction Program affected the Board?

Answer. The Board has been working very closely with the Office of Personnel Management [OPM] and the Office of Management and Budget [OMB] on this project. Both agencies realize that because the Board is made up principally of attorneys at the GS–11 through GS–15 levels, we have less flexibility to reduce the percentage of our staff at these grades than do many other Federal agencies. We are carefully reviewing all new hires and promotion actions to ensure that all these actions are consistent with the goals of OPM and OMB. The 1986 request reflects a reduction of $88,000 based on these efforts.

OFFICE OF THE SPECIAL COUNSEL

STATEMENT OF K. WILLIAM O'CONNOR, SPECIAL COUNSEL

ACCOMPANIED BY:

LYNN R. COLLINS, DEPUTY SPECIAL COUNSEL

H. ALMA HEPNER, DIRECTOR, CONGRESSIONAL AND PUBLIC RELATIONS

PREPARED STATEMENT

Senator ABDNOR. Good afternoon, Mr. O'Connor. We want to welcome you back to the committee and we are looking forward to you and your colleagues testifying. You are familiar with this. Proceed any way you would care to, but I can assure you that your entire statement will be made a part of the record.

Mr. O'CONNOR. Thank you, Senator. I would like to request that and I appreciate the committee's indulgence in making it a part of the record.

[The statement follows:]

STATEMENT OF K. WILLIAM O'CONNOR

Please let me thank you for inviting me here today to discuss our budget request for fiscal year 1986.

Consistent with the Administration's budget, the requested budget authority for FY 1986 is $4,594,000 with 86 FTE positions. This represents a decrease of $33,000 under the FY 1985 anticipated appropriation of $4,627,000 and maintenance of the current year FTE level. Accomplishment of FY 1986 operations at the requested funding will be met through delayed hiring for vacancies and by selective application of resources. (Please see Attachment A.)

By statute, OSC is required to investigate, and if evidence warrants, to prosecute all allegations of prohibited personnel practices, prohibited political activity, arbitrary or capricious withholding of information under the Freedom of Information Act and any other activity prohibited by civil service law, rule or regulation.

The office is specifically charged with providing a safe channel through which disclosures of waste, fraud and abuse may be made, and with protecting whistleblowers from reprisal. A profile of the pending workload is attached for your information. (Please see Attachment B.)

I come before you today to claim a victory. The office is doing more with less at a faster pace than ever before.

The successful completion of FY 1984 operations was accomplished as the result of stable funding and consistent staffing and leadership. The year represented significant progress toward full program effectiveness and prompt fulfillment of OSC statutory obligations.

First let me tell you a little about the recent management reorganization in the office. Lynn Collins, formerly Associate Special Counsel for Prosecution has

been appointed Deputy Special Counsel. Last month a new division was established within the office. That office, the Planning and Oversight Division is headed by Shigeki J. Sugiyama, formerly the Associate Special Counsel for Investigation, now Associate Special Counsel for Planning and Oversight. That division will have specific responsibility, among others, for coordinating OSC policy development and implementation, and for planning, coordinating, inspecting and evaluating all program operations of OSC. Robert L'Heureux, formerly Deputy Associate Special Counsel for Investigation has assumed responsiblity for all OSC investigatory activity and is now Associate Special Counsel for Investigation. William Reukauf, formerly Deputy Associate Special Counsel for Prosecution has been promoted to Associate Special Counsel for Prosecution. (Please see Attachment C.)

During FY 1984, major management initiatives included full implementation and refining of the system for reviewing incoming matters, promptly identifying

those with potential for prosecution and initiating appropriate investigation; and implementation of the office's internal control system with emphasis on quality control and further increases in efficiency. These efforts have resulted in the reduction of the number of matters pending from 843 at the beginning of FY 84 to 416 at the end of FY 84. The number of completed actions was 26 percent above the number of new receipts.

The primary objective of the office continues to be a responsive and efficient operation which protects the integrity of the merit systems and thus ensures for those systems and the federal employees within those systems the statutory protections for which the office was established. To achieve this objective, the Office must deal properly and promptly with each allegation or complaint received. To this end, each complainant is contacted personally to assure that the nature of the allegation or complaint is correctly and completely

understood. Priority is then given to full investigation of matters with patent prosecutive merit.

In order to ensure that employees are aware of the functions of the OSC and that a responsive relationship is maintained with the Congress, the Public and the Press, I continue to emphasize our ongoing outreach program.

During FY 1984, the office of Congressional and Public Relations distributed over 79,000 copies of OSC informational materials to the public and Congress. This represents a substantial increase in outreach activities over the previous fiscal year. (Please see Attachment D.) In addition, the Office responded to an average of 300 press and Congressional inquiries per month, and produced and dispatched some 2,300 letters to the press, Congress and the public. Automated systems including personal computers have been installed to promptly and accurately track matter-related inquiries from Congress

and the Executive branch. Continued emphasis on outreach and responsiveness is planned in FY 1985.

Last year I reported to you that a Complaints Examining Unit (CEU) had been established in the OSC headquarters office. The CEU is staffed by 11 employees. In staffing the unit we have sought experienced attorneys, investigators and personnel management specialists. The average professional grade is approximately GS-13. The decrease in the age of all pending matters may be attributed to the CEU and to the organization of an effective investigative division. Experienced criminal investigators and supervisors have been employed and have trained pre-existing staff in law enforcement investigative techniques. Investigations are field oriented, highly focussed and intense. In staffing the Investigative Unit I have stressed recruiting investigators with criminal law enforcement backgrounds. As a result a large number of re-employed annuitants, we call them "Grey Wolves", now work in the Division. Because of

this novel approach in hiring OSC has been able to obtain investigators with 40 years experience at a novice price. OSC investigators formerly served in such agencies as the Intelligence Division of the Internal Revenue Service, the U.S. Naval Investigative Service, the Air Force Office of Special Investigation, Offices of Inspectors General, the Internal Affairs Division of the Washington, D.C. Police Department, and state or local law enforcement agencies. The object of law enforcement investigation is to obtain evidence with which to enforce the laws. That object is being attained. Administrative subpoenas are routinely issued and enforced; sworn, transcribed interviews are common practice. Witnesses, subjects and targets may be represented by counsel during interrogation. These investigative practices lay the groundwork for solid cases which are then presented to the MSPB.

During FY 1984, examination and investigative action was completed on more than 80 percent of the total

number of matters and cases handled during the year. That figure includes the 843 matters carried over into the fiscal year. In FY 1985, action is expected to be completed on 1,700 of the total workload of 2,100 matters (including the 416 matters and cases carried over from FY 1984.) Improved processing procedures resulted in stabilization of the average age of all pending matters and cases in the Office, including time-consuming action on whistleblowing referrals and litigation cases, to a range between 100 and 120 calendar days. This is a dramatic drop from previous fiscal years. The average age of the pending workload in October 1982 was over 170 days. The average age of all pending matters and cases at the end of FY 1984 was 108.7 days. As of March 11, 1985, that number was further reduced to 102.6 days. (Please see Attachment E.) A breakdown of that figure reveals that pending matters involving alleged prohibited personnel practices and Hatch Act violations are an average of 75.0 days old. That figure exceeds the goal I set for the office in October 1982, when I was confirmed

as Special Counsel, to achieve an average age of all matters of 90 days or less. Cases currently pending in litigation average 403.4 days; the oldest of these are awaiting decisions by the Board. Pending whistleblower referrals are an average of 175.8 days old; much of that is attributable to the time which the agencies need to conduct a proper investigation and provide a report from the agency head as required under the statute.

Decreasing time per matter was accomplished while at the same time reducing, through attrition, the staffing level from 90 FTE at the end of FY 83 to within the 86 FTE ceiling during FY 84.

It should be noted that since my tenure as Special Counsel began, in October of 1982, the office has improved efficiency and effectiveness while accommodating to the 28 percent cut in FTE ceiling. (Please see Attachment F.)

A major administrative initiative during FY 1984 was the relocation of the central office to new quarters, achieving the Administration's goal for space utilizations of 135 square feet per person in the central office.

One of the most noteworthy occurrences in the area of administration was the severance at the end of FY 1984 of the Office of the Special Counsel's administrative interaction with the MSPB. In July, MSPB Chairman Ellingwood and I jointly announced the establishment of separate administrative operations for the two agencies. We agreed that the administrative reorganization would enhance the efficiency of our respective agencies. The change necessitated modification of the OSC's Operations Management Division, which assumed full responsibility for all OSC general ledger accounting, payroll and procurement, in addition to its previous functions. The relationship of the agencies remains friendly and cooperative. OSC provides MSPB with computer services on

a reimbursable basis, obviating the need for MSPB to purchase expensive equipment and software; MSPB assists OSC on a reimbursable basis in other administrative areas.

Despite the additional work assumed by OSC, the net effect will be smoother and more rapid handling of administrative activities with a negligible increase in cost, which is being offset by economies being achieved through increased efficiency.

In early FY 85, in accordance with the Administration's Reform 88 initiatives, the office's personnel/payroll and accounting activities were transferred to the Department of Agriculture's National Finance Center System in New Orleans. Administrative payments and other activities are handled at the larger facility, further streamlining OSC administrative operations.

More efficient utilization of staff resources was realized by the closing of the Chicago field office at

the end of FY 84. Career staff review revealed that continued operation of that field office was not cost-effective. Workload and staff positions were absorbed into the central office. The five field office staff members were offered lateral transfers to the Headquarters office. While the investigators accepted the offer, the attorney and clerical staff declined. Those who declined, however, were given three months notice to obtain other employment.

During the last fiscal year and the first part of FY 1985, a concerted effort has been undertaken to upgrade the office's management information systems. In December, development of a Litigation Reporting System was begun to gather additional information concerning all the cases the office has filed before the MSPB, corrective actions initiated with the agencies and any other litigation activity. Additional improvements to the system for compiling whistleblowing referral data

and investigative management data collection are also underway.

During the first part of the fiscal year, a system was established to provide immediate and current information on the status of all files retired to a federal record center. This information is instantly available to all OSC staff.

In order to formally establish and perpetuate OSC procedures the office has compiled manuals which set forth written procedures for the Investigation and the Prosecution Divisions. Additionally, an administrative manual is in the process of completion.

The efficiency achievements and staff reorganization are meaningless unless they produce results. During FY 1984, 41 referrals of problems of waste, fraud and abuse disclosed by federal employees were made to agency heads under the statute, and 54

informal referrals were made to agency Inspectors General. Based on current trends, it is projected that 55 statutory referrals and 45 informal referrals will be made during FY 1985. It is further projected that 65 statutory referrals and 45 informal referrals of such allegations will be made in FY 1986.

Also during the last fiscal year, six non-Hatch Act disciplinary actions were initiated before the Merit Systems Protection Board. The year also marked the first time in the history of the office that decisions were issued by the MSPB upholding our efforts to discipline employees for whistleblower reprisal. So far in FY 1985, five disciplinary action complaints involving prohibited activities have been filed with the MSPB.

In the area of Hatch Act enforcement, five disciplinary action cases were filed with the MSPB during FY 1984, and five more have been filed since the beginning of FY 1985.

The goal of the office continues to be prompt identification, investigation and initiation of prosecution when warranted, of all meritorious matters within 90 days of receipt. Of equal importance is the prompt disposition of clearly non-meritorious matters and matters not within the jurisdiction of the office within 30 days of receipt.

At the current budget set by the Administration, we are able to discharge the responsibilities vested in the OSC by Congress. Any reduction by Congress in the Administration's plan would place a severe strain upon our ability to carry out the statutory law enforcement scheme designed by Congress for execution by OSC which includes the variety of activities I have described to you today.

This concludes my formal statement which, along with our budget justification, summarizes the need for

our budget request of FY 1986 of $4,594,000 as submitted by the President.

I would be pleased to answer any questions that you or other members of the subcommittee may have at this time.

ATTACHMENT A

OFFICE OF THE SPECIAL COUNSEL FUNDING RATES

JANUARY 1, 1979 TO PRESENT

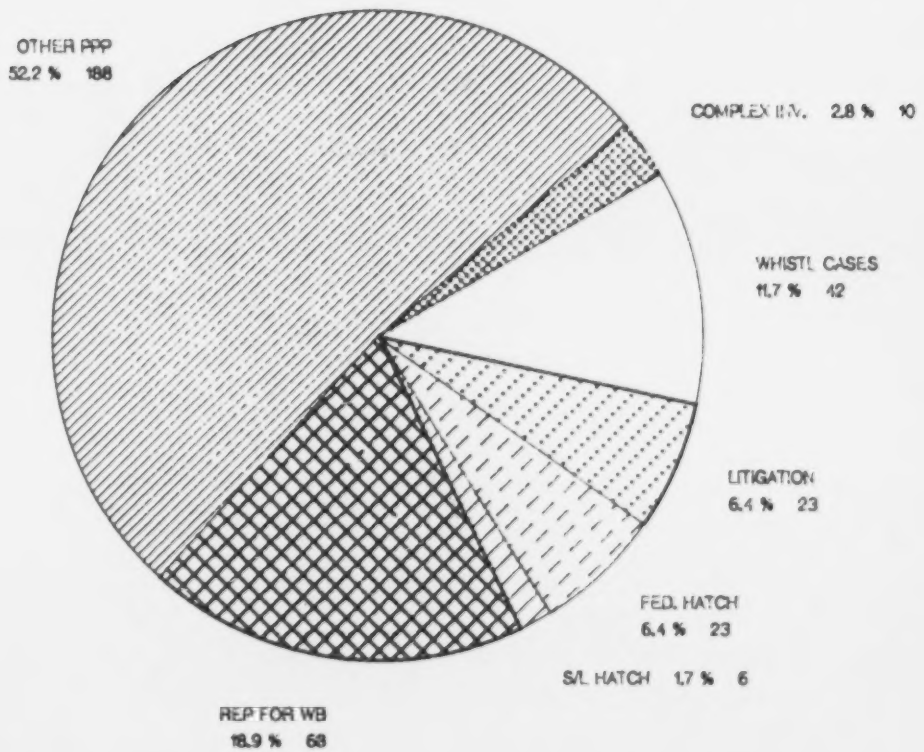
AUTH. RATE

CRG200, FISCAL YEAR QUARTERS

ATTACHMENT B

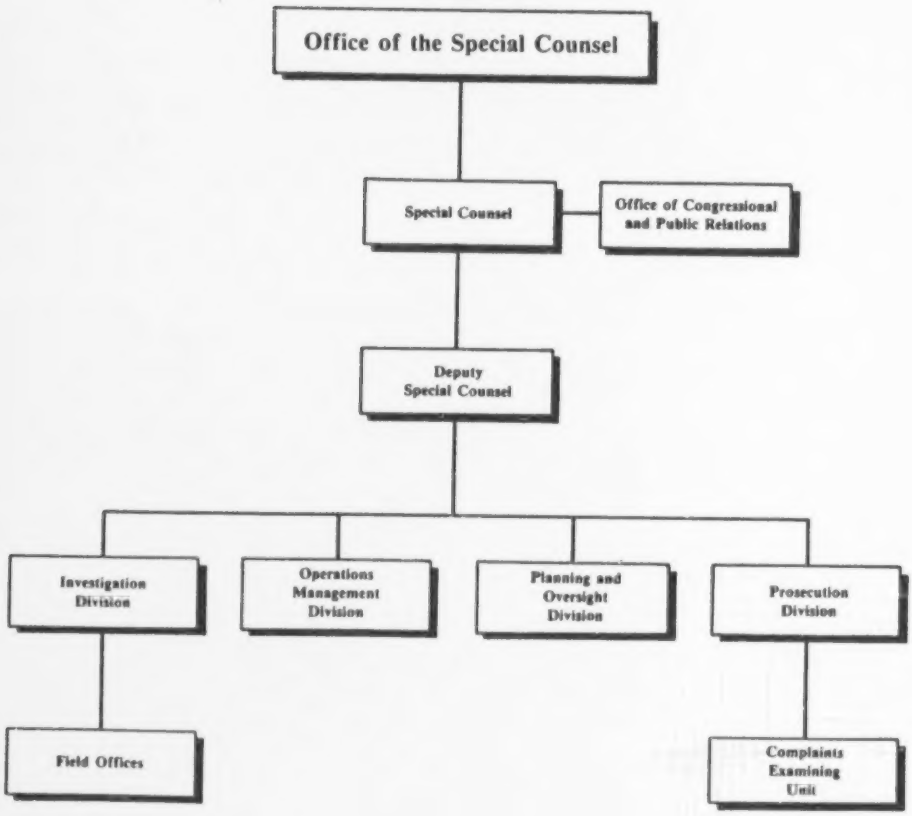
PROFILE OF PENDING MATTERS BY TYPE

AS OF MARCH 11, 1985



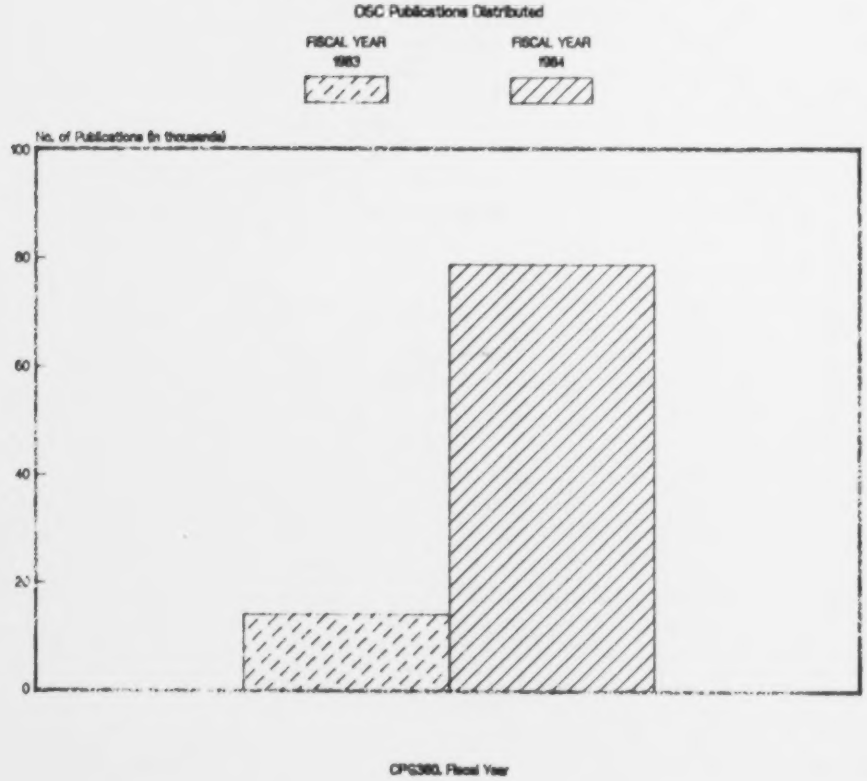
CR59, 360 MATTERS - AVERAGE AGE = 108.6 DAYS

ATTACHMENT C



ATTACHMENT D

SPECIAL COUNSEL OUTREACH ACTIVITIES

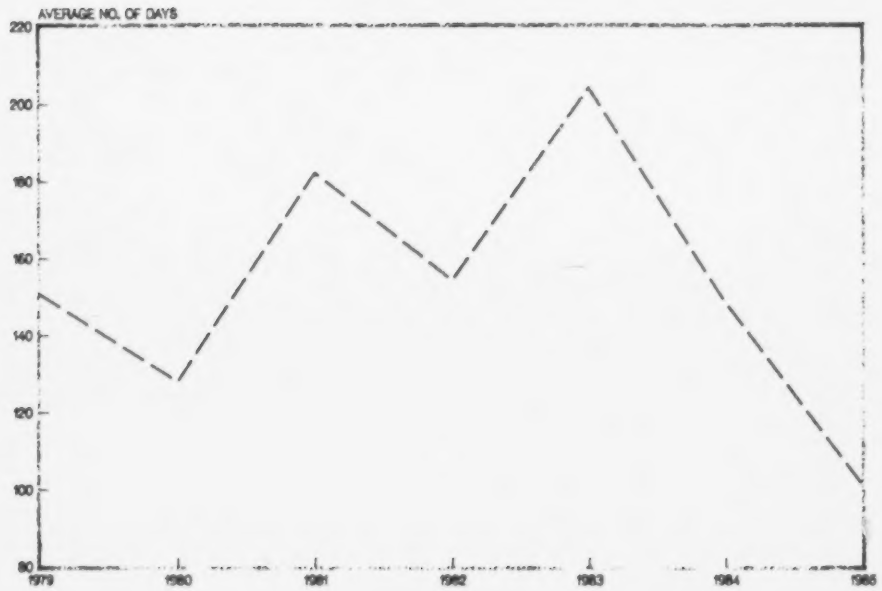


ATTACHMENT E

AVERAGE PROCESSING TIME

ALL MATTERS AND CASES

DATE REC'D
TO DT. CLSD

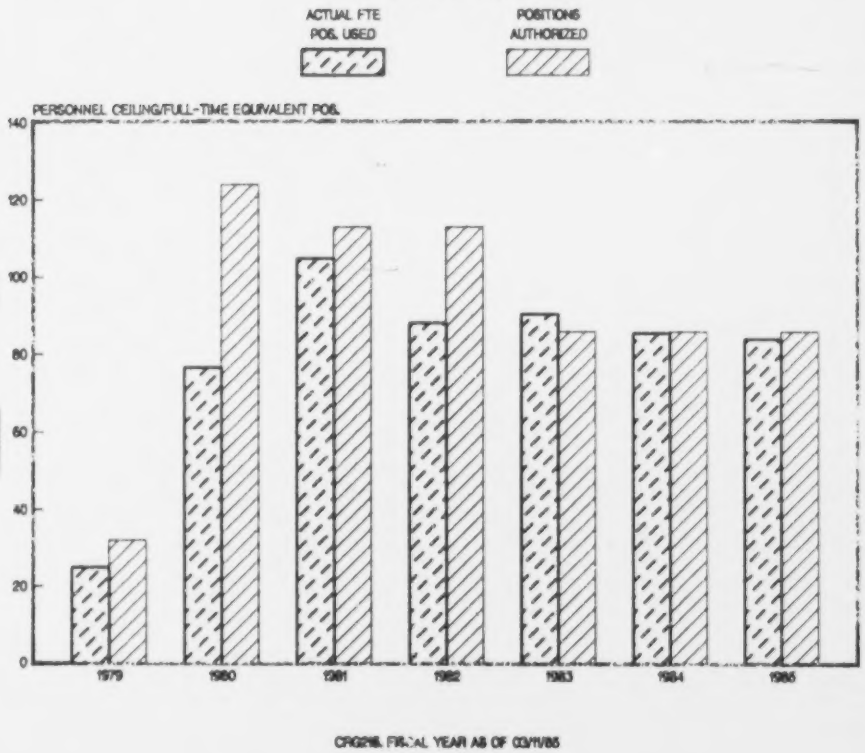


CRF381/FISCAL YEAR

ATTACHMENT F

PERSONNEL CEILINGS AND ON BOARD STRENGTH

FISCAL YEARS 1979 THROUGH 1985



ORIGINS: FISCAL YEAR AS OF 03/11/85

INTRODUCTION OF ASSOCIATES

Mr. O'CONNOR. I am accompanied here by my newest staff appointment, Mr. Lynn Collins, who is the Deputy Special Counsel. That is a position that we have not filled until now. Mr. Collins is appearing in this role for the first time. He is a career civil servant who grew up in the system and he knows a lot more about most of the things that the Merit Systems Protection Board's Office of Special Counsel does than most other people.

I am also accompanied by Alma Hepner, the Director of Congressional and Public Relations. She has, I know, dealt with the staff of the Senate and the House throughout my tenure here.

Senator ABDNOR. She has had to put up with us before.

Mr. O'CONNOR. I do not think she ever phrased it that way, Senator. [Laughter.]

Senator ABDNOR. We welcome you to the hearing here today. This is your first time with us.

Mr. COLLINS. Thank you, Mr. Chairman.

Senator ABDNOR. Sorry I do not have a better voice for this.

SUMMARY OF WRITTEN TESTIMONY

Mr. O'CONNOR. Mr. Chairman, I would like to just very briefly summarize the testimony, and I will be brief. We are requesting $4,594,000 and 86 FTE, which is consistent with a small reduction from last year's budget for 1985—about $30,000 less—and we are holding at the same FTE level in our request.

The Office of Special Counsel has continued to improve, in my view, and I think that we now are in a position to say that we are beginning to be a successful operation in the Government.

We have found ways to enhance the quality of the cases we are bringing by enhancing the quality of the investigations that are performed. We have established a very effective system of screening complaints to separate the less worthy matters from the more worthy ones so that resources are quickly focused on matters worthy of concern.

We have had great success in the referral of the whistleblower matters that come to our attention and are referred to agencies for action.

HIRING REEMPLOYED ANNUITANTS

There is one other matter that I would mention, and it is that we have found a way, in my view, to do something that is very worthwhile in the Federal Government. You know that many agencies cause the retirement of their people in investigation, in what is called the 1811 category, when they are criminal investigators when they reach a certain age.

We have hired such people from either military retirement or from other law enforcement agencies. We are presently staffed with men who, together, put literally hundreds of years of experience into their work for a cost much less than we have to pay for novice employees in the same kind of investigative area.

So although we have a very small investigative staff, the resource value is rich and we are finding that that produces a result which is consistent with what we would hope for in law enforcement, and that is that people who are charged now more and more frequently say, "Oh, I concede the point; let us see what kind of an arrangement we can make for settlement." That, in my view, is a measure of law enforcement success that I would like to claim.

Senator ABDNOR. Well, you certainly are to be congratulated on your productivity. I guess that tells us why now; you get more production with experienced people to carry out the work.

Mr. O'CONNOR. And cheaper, too.

DEALING WITH A $33,000 BUDGET REDUCTION

Senator ABDNOR. How are you going to absorb the $30,000 reduction, assuming there is no salary increase?

Mr. O'CONNOR. Well, the $30,000 may turn out to be absorbed without any significant problem either by a lapse factor in salaries, or something like that. My guess is that we will take care of it in lapse without

too much trouble. I think that we will not have a great deal of difficulty accommodating up to 1 percent, and $33,000 is less than 1 percent.

Senator ABDNOR. That is great. These are the most encouraging hearings I have ever held. All you gentlemen do a great job.

Well, I had better let you go ahead.

Mr. O'CONNOR. No; I am ready for your questions, sir.

Senator ABDNOR. Are we going to see more of these whistleblowing cases as you go along?

WHISTLEBLOWER DISCLOSURES

Mr. O'CONNOR. I think that we are going to find more and more of the people who have waste, fraud, and abuse to report using the channels that are set up in my office and in the offices of the statutory inspectors general, which provide protection for the person who makes a disclosure.

I think that overt disclosures are often going to be inhibited by the concerns that people have expressed as in Mr. Ellingwood's Merit Systems Protection Board's Office of Research.

They found that a great many people are inhibited, but they are not inhibited from using the covert, as I call it, channel, and that is the one I encourage people to use because I think that it gets the message to the people who want to take action promptly and effectively.

We have found that when we give that message which we receive from, let us say, a person who wishes to not have their identify disclosed to the head of an agency or the responsible executive in an agency, invariably action is taken that is consistent with correction of the problem.

There is no reticence at the highest levels of the Government to take action, and I think these channels will work effectively and continue to work effectively, but there is a limited amount of volume of that sort of work.

Senator ABDNOR. You do not detect any reprisals going on?

Mr. O'CONNOR. Well, not in those matters. We have a couple or three reprisal cases pending before the Board at any given time, and we have had one successful win in one matter and another successful win in another matter involving reprisal during the past year.

Those are innovations in the office's history because until those cases, we had not won anything. So it seems to me that the litigation and investigation personnel involved ought to be commended for it, and I have.

Senator ABDNOR. Is that because of better handling of the case or better evidence, or what?

Mr. O'CONNOR. Well, Mr. Chairman, I am an old prosecutor and my view of a case is you get the evidence first, and if it is good, then you go ahead and try the case and you should win if you have got a good evidenciary base.

That is what we are getting. That is what my gray wolves go out and get, and let me tell you, when I let those gray wolves out of their den in the morning, let people beware if they have been conducting reprisals because they will be caught.

Senator ABDNOR. I guess when you have good people, those are the results.

Mr. O'CONNOR. Well, they are former police officers, former special investigators with the military, former officers of the Internal Revenue Service, special agents of that kind—people who understand criminal law enforcement.

We are dealing with cases that are just as hard to prove as any criminal case and shake the reputation of the people involved, irrespective of which side, just as much. So I think it is appropriate to do that kind of investigation.

Senator ABDNOR. You do all this with 86 people?

Mr. O'CONNOR. Yes, sir.

Senator ABDNOR. More people ought to read about that side of Government.

Mr. O'CONNOR. Well, we think that it is sufficient for the problem, sir.

Senator ABDNOR. Are you getting more or less frivolous cases now? Some of them are not always as meritorious as others. Are you finding that those that are coming in more and more are the major type cases?

THE COMPLAINTS EXAMINING UNIT

Mr. O'CONNOR. Well, we are getting a great deal of very frivolous complaints, sir. That is why the complaints examining unit is so valuable. Everything comes in through the mouth of the funnel, which is called the complaints examining unit.

Those attorneys and investigators there, who are GS–13 average level and quite experienced people themselves, screen the matters, contact the complainant, find out from the complainant what is going on. Then, if the matter is not within our jurisdiction or is not meritorious, that is clearly identified and shut off.

The result of that is that you immediately get to the meritorious matters. Also because of that, we have been able to achieve what I think is an important criterion of law enforcement, and that is a shortening of the time from complaint to disposition.

AGE OF PENDING MATTERS

When I came into this position, the average age of pending matters was 200 days; today pending matters are 75 days of age or less now.

Senator ABDNOR. Really?

Mr. O'CONNOR. Yes, sir; and it seems to me that action delayed is action denied in most instances. So we are working to now hold it either to 75 or go to 60 days. My pledge when I came in was 90 days. We have surpassed that pledge and now I want to go better.

Senator ABDNOR. That is great. The whistleblower—I keep going to that—do they take longer?

Mr. O'CONNOR. Yes; whistleblower referrals distort the figures somewhat because a whistleblower matter that goes to an agency for action will usually require the agency's head to assign it to his inspector general to conduct a detailed investigation.

That can take 3 or 4 months, and although we remain in constant contact, it is important to me and to the enforcement of the law that the agency head get the fullest and most complete report from his inspector general.

So that may be a time-consuming activity. We are neither funded for or authorized to conduct that kind of investigation, and so the inspector general does it. When that report comes back to us, there may have been a significant time lag.

On matters involving whistleblower reprisal, if it is an actionable reprisal we go to litigation, that also takes time because we make a very thorough investigation before proceeding with litigation. That takes time, and then once you start litigation, any time you encounter lawyers, you know you are encountering delay. And I guess I can say that without other people denying that I am correct about it.

So it is not necessarily possible to expedite a matter through a court. A judge can only move something as quickly as the lawyers will allow it to go.

Senator ABDNOR. That is true. Well, let me tell you that I think you are certainly to be commended for your—you have reduced your personnel and you have increased your productivity. That is a great record.

Mr. O'CONNOR. Thank you, sir.

Senator ABDNOR. More people ought to read about that in Government, and I commend you and your staff for it, and we thank you for being with us.

Mr. O'CONNOR. Thank you, Mr. Chairman. We appreciate the opportunity to appear.

Senator ABDNOR. Thank you.

NATIONAL ARCHIVES AND RECORDS SERVICE

STATEMENT OF ROBERT M. WARNER, ARCHIVIST OF THE UNITED STATES

ACCOMPANIED BY:

GEORGE N. SCABOO, DEPUTY ARCHIVIST OF THE UNITED STATES
CLAUDINE J. WEIHER, ASSISTANT ARCHIVIST FOR ADMINISTRATION
RAYMOND A. FONTAINE, COMPTROLLER

OPENING REMARKS

Senator ABDNOR. Our final witness today is Dr. Robert M. Warner, Archivist of the United States, who will present the budget of the National Archives and Records Service.

I know it is not the first time you have been with us, Dr. Warner. Of course, it is not the first time you have appeared before this committee, but I guess it is the first time you will be presenting the Archives' budget in the manner that you are going to be doing.

I should note for the record that the Archives will become an independent agency on April 1, so this is really a red-letter day for the Archives. It does have a downside, however. Dr. Warner is stepping down as the Archivist, and I want to thank you for all you have done, Dr. Warner.

Dr. WARNER. Thank you.

Senator ABDNOR. You have been a great figure in all of this. Yours is not an easy task. We want to wish you the very best as you retire. I am sure you are going to have a hard time staying away from that great place.

If you will just introduce your colleagues and proceed as you would care to.

INTRODUCTION OF ASSOCIATES

Dr. WARNER. I would be pleased to do so, Senator, and thank you for those very generous remarks. Let me introduce my colleagues at the table. On my right is George Scaboo, Deputy Archivist of the United States, who also will be retiring shortly.

On my left is Claudine Weiher, Assistant Archivist for Administration, and on her left is Raymond Fontaine, the Comptroller of GSA.

PREPARED STATEMENT

Mr. Chairman, I would like to submit a formal statement for the record.

[The statement follows:]

STATEMENT OF ROBERT WARNER

I am Robert Warner, Archivist of the United States. I have with me today George Scaboo, Deputy Archivist, and Claudine Weiher, Assistant Archivist for Administration.

I appreciate the opportunity to appear before you to present the proposed 1986 budget for the National Archives and Records Administration [NARA]. As you know, this agency will be established on April 1, 1985, by enactment of the National Archives and Records Administration Act of 1984 (Public Law 98-497) on October 19, 1984. This account will assume all of the liabilities, obligations, and commitments of the General Services Administration's "Operating expenses, National Archives and Records Service" account plus the existing National Archives trust fund and gift fund and will acquire some administrative functions from the General Services Administration. As the successor agency, our continuing primary function is to preserve the Nation's cultural heritage by protecting and making available the documentary record of our National Government, and to carry out our related responsibilities in the areas of the creation, selection, preservation, use, and disposition of Federal records. Throughout the country in 11 field archives branches, and here in the National Archives Building in Washington, we make the Nation's records of enduring value available for research by the Federal Government, scholars, and the general public.

We administer the system of Presidential libraries where papers and historical materials of American Presidents, and the papers of their associates, are preserved and made available for research. Each year a large number of visitors view significant historical materials displayed in major exhibits in the Presidential libraries. In addition, Presidential materials are administered pending the establishment of Presidential libraries.

NARA operates a system of 14 Federal records centers where noncurrent Federal records are stored and serviced economically for Federal agencies until eligible for disposal or transfer to the National Archives. Each year this program results in substantial cost savings for the Government by removing records from expensive agency office space to low cost storage space provided by the center system, and by carrying out an active and effective Records Disposition Program.

NARA is responsible for publishing administrative regulations, the laws, and Presidential documents, in the Federal Register and related publications. We make available to the general public all of the significant rulemaking of the executive branch.

Another of our important activities is the National Historical Publications and Records Commission. Although Public Law 98-189 reauthorized the Commission from 1984 to 1988, including authorization of $4 million in 1984 and 1985, and $5 million in each of the succeeding 3 years, grant funds are not being requested for fiscal year 1986. In fiscal year 1986 the Commission will continue in its advisory capacity coordinating and making recommendations on high priority publications and records projects and actively seeking private support for the program.

NARA also reviews for declassification security classified permanently valuable records and historical materials. Related to this topic, the Information Security Oversight Program was transferred to GSA in fiscal year 1985.

CHANGES FROM FISCAL YEAR 1985

Our fiscal year 1986 request of $104,063,000 for direct operating expenses is an increase of $5,245,000 from the fiscal year 1985 budget level. Changes include $3 million for preservation, $315,000 for shelving in records centers, $197,000 for recurring reimbursable payments to the Federal Buildings Fund [FBF], $1,682,000 for the increased cost of goods and services, $541,000 for operation and maintenance costs for the National Archives Building and Presidential libraries, $401,000 for closing out the Mechanicsburg, PA, facility, $449,000 for payments to the FBF for standard level user charges [SLUC], $1,973,000 for the annualized cost of the transfer from GSA, and $4,700,000 deferred from fiscal year 1985 for improvements to the Kennedy Library. These increases are offset by reductions of $2,441,000 for the fiscal year 1982 supplemental carry forward, $4 million for grants, $451,000 for Grants Program carry forward, $159,000 for the grade reduction initiative, $500,000 for one-time costs in fiscal year 1985, $186,000 for the 5-percent pay reduction, and $276,000 for the 10-percent administrative services reduction.

PRESERVATION

Preservation of our Nation's documentary heritage continues to be of the highest priority to NARS. Our preservation workload is determined by the quantity and condition of archival records. Many archival records require treatment in order to preserve them for future use. At our request, the National Bureau of Standards assisted NARA in identifying immediate and long-range preservation needs that require action over an extended period. Based on this, NARA prepared a 20-year preservation plan, which prescribes a systematic course of action to alleviate the current preservation backlog and to preclude the creation of any new workload. Our 1986 budget includes $8,585,000 for preservation, an increase of $3 million above the basic program to implement the first year of the 20-year preservation plan.

SUMMARY

Except for the increase in the Preservation Program, and no funding requested for the Grants Program, this budget is basically a continuation of programs at the fiscal year 1985 level and is intended to enable us to carry out our basic mission. It represents our assessment of resources necessary to continue the ongoing programs which are our mandated responsibilities.

Thank you for the opportunity to make this brief statement, Mr. Chairman. I will be pleased to respond to your questions.

BIOGRAPHY OF ROBERT M. WARNER

Personal data.—Born June 28, 1927, Montrose, CO; current residence: 6440 Gerard Court, Falls Church, VA 22043; married.

Education.—Ph.D. 1958, University of Michigan; M.A. 1953, University of Michigan; B.A. 1949, Muskingum College; and student, 1945, University of Denver.

Professional experience.—Archivist of the United States, 1980–present. Director, Michigan Historical Collections, 1966–80. Professor, School of Library Science, University of Michigan, 1974. Professor, Department of History, University of Michigan, 1971.

Professional societies/awards.—Fellow, Society of American Archivists (president). Member, American Historical Association (member of council). Member, Organization of American Historians. Member, American Association for State and Local History. Member, Society for History in the Federal Government. Member, Historical Society of Michigan (president). L.H.D. Westminster College (PA) 1981 (honorary). LL.D. Muskingum College 1981 (honorary). L.H.D. DePaul University 1983 (honorary).

Miscellaneous.—None.

BIOGRAPHY OF GEORGE N. SCABOO

Personal data:

Date of birth: August 10, 1922.
Place: Sioux City, IA.
Residence: 8301 Traford Lane, Springfield, VA 22152.
Marital status: Married.

Education:

Bachelors' degree in business administration, University of Omaha (1963).

Professional experience:

1982–present—Deputy Archivist of the United States.
1979–82—Assistant Archivist for Federal Records Centers.
1976–79—Deputy Assistant Archivist for Federal Records Centers.
1974–76—Director, Center Operations Division.

1970–74—Held various positions in the Office of Federal Records Centers.
1970—Retired from the Navy with the rank of Captain.
1968–70—Staff of the Chief of Naval Operations, Washington.
1966–68—Chief of Staff, 3rd Naval District, NY.
1965–66—Executive officer, U.S.S. *Delta* (AR–9).
1963–65—Executive officer, Navy Records Center, Bainbridge, MD.
1960–63—Commanding officer, Navy Records Center, Omaha, NE.
1942–60—Service in the U.S. Navy beginning as a fighter pilot in World War II. Rose through ranks holding commands both at sea and ashore.

Professional societies:

Naval Reserve Association; Association of Records Managers and Administrators; and Society of American Archivists.

BIOGRAPHY OF CLAUDINE J. WEIHER

Personal data.—Born Kansas City, MO; November 24, 1941. Current residence: Washington, DC.

Education.—M.A. 1967, in history, Georgetown University; B.S. 1963, in history, University of Missouri.

Professional experience.—Assistant Archivist for Administration, November 1982–present. Acting Assistant Archivist for Program Support, February 1982–November 1982. Deputy Assistant Archivist for Program Support, 1976–February 1982. Director, Planning and Analysis Division, 1973–76. Program analyst, 1971–73. Chief, publications sales branch, 1970–71. Staff archivist, 1967–70. Staff assistant to Hon. W.R. Hull, U.S. House of Representatives, 1965–66.

INDEPENDENT AGENCY STATUS

Dr. WARNER. I might comment very briefly on a couple of the significant events which you alluded to and the budget which is currently before the Congress.

As you noted, this will be the last time that I will appear before this committee to represent the National Archives. On April 15, I will be stepping down to assume new responsibilities at my former institution, the University of Michigan. So it is a bittersweet situation from my perspective.

One of the things I will miss is the opportunity to meet with you and testify for the National Archives programs. But I am very pleased that one of my last official acts as Archivist of the United States is to present the first budget for the newly independent National Archives and Records Administration.

I consider the reestablishment of the National Archives as an independent agency to be a significant achievement for everyone who participated in support of this effort, and this means you folks in the Congress, a decisive factor; the administration; the many historical, archival, and other constituent groups and the whole academic community who worked toward that goal, and worked successfully toward that goal.

The collective wisdom of all these participants, recognizing the need and acting vigorously to achieve the goal of independent status for the Archives, cannot be overstated. It is really a monumental achievement, I think, that has received much attention.

I think the Archives now is in a position to take its rightful place in the Federal Government to ensure the continuity of Government and the rights of a free people through the careful preservation of the records of the Nation, and that, of course, is the main mission of the National Archives.

I do appreciate the support provided by this committee over the years and feel confident that this support will continue to ensure a strong, independent agency. Having taken this important step, we must ensure that the agency has the wherewithal to carry out its mission.

TRANSITION PERIOD

I also can bring you some other happy news today, Mr. Chairman, and report that the transition to an independent agency has been a very smooth one. This has largely been due, I think, in a very commendable way to the cooperative spirit and leadership provided by GSA's Acting Administrator, Ray Kline, and by our friend, the Comptroller, Ray Fontaine.

It has been possible through their efforts to use the last several months since the President approved the legislation to have the new agency's structure and procedures in place to enable the National Archives to assume its new role on April 1 with very great ease. It has been a smooth and very pleasant transition, and I think sometimes we do not always see that in Government.

As part of the transition, we have received from GSA sufficient resources to provide for ourselves the necessary administrative support that was previously provided by GSA. Separate agency status also, it is very important to note, has not resulted in increased costs to the Government.

With the transition just about over, we can now get on with the important work that has to be done. And, of course, I think we all realize that independence does not solve all our problems. It opens opportunities to solving them. There is much to be done.

PRESERVATION INITIATIVES

The fiscal year 1986 budget request addresses the continuation of ongoing programs and provides for new initiatives in preservation. The budget provides for an increase of $3 million to begin the first year of a 20-year preservation plan which is aimed at systematically addressing the current preservation backlog, and will prevent future backlogs from developing in that vital area.

Other than this increase, the initial budget for the new agency changes very little from the 1985 fiscal year budget, except in the grants area. Continued funding for this program, as in past years, will be left to the Congress to determine.

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FUTURE ISSUES

As I leave this office, I recognize that while we have accomplished much in putting the agency on a sound track and achieving the independent status necessary to preserve and pursue the agency's future needs vigorously, there are still many challenges that lie ahead.

Take, for example, technology, a very important factor. We have got an initiative underway that seeks to describe and store records by using new methodologies. This must be pursued with great vigor in the future years. I am convinced of that.

We need to ensure that the preservation initiatives are continued. The request this year is the first of a 20-year program that is needed to really bring about a solution to that problem.

All of us must face the fact sometime that the piecemeal approach to solving the major facilities problem that we have at the Archives will not be satisfactory. We are now in the process of developing a master plan which seeks to remodel the existing National Archives Building. I think that is very, very important.

But that does not really address another major problem. We do need a major new additional structure for the National Archives to bring together the various programs that are scattered throughout the District, and to provide an adequate future for safe preservation of the records of this Nation.

I think the next Archivist will be looking to the administration and to the Congress for support on this issue and many other issues.

It is a pleasure to bring these introductory remarks, and we would be very pleased to answer your questions.

MASTER PLAN FOR THE ARCHIVES BUILDING

Senator ABDNOR. Well, thank you. What does this master plan consist of?

Dr. WARNER. What we are doing is looking at the existing building. We have had a professional firm come in and analyze the building. As you know, it is now over 50 years old and there has never been any major remodeling of that building. Times have changed, equipment needs have changed, storage requirements have changed.

So this will address changes in that building, and I think that will be very significant when we have the results of that study in. It is done by a very well-known firm, a very fine firm.

ARCHIVES ANNEX

But as I indicated, this is only part of the story. We do have facilities in Suitland, in Virginia, and in various places. These need to be brought together in a new facility someday, and that problem has got to be faced, it seems to me, in the future.

Senator ABDNOR. It will be interesting to see the results.

Dr. WARNER. Well, it will be, and it is exciting and there are good ways to pursue it. I think we have a good model in the Smithsonian.

They have erected a very fine building out in the Suitland area, a very effective, economical building that is quite functional and is meeting their needs and will meet their needs for the next 30, 40 years.

I think a new structure something like that, which was not terribly expensive, looking at the whole scheme of things, is something that the Archives should pursue with great vigor and great success.

ADDITIONAL POSITIONS

Senator ABDNOR. Speaking of the budget, it proposes new permanent positions totaling 76. Can you give us some idea where these positions are going to be utilized?

Dr. WARNER. I would be very pleased to. As we mentioned, we have one major program initiative, and that is in the preservation area. These people will largely be used in the preservation of historical documents. They will be used in a number of ways.

We have recently refurbished our laboratory, which is the area in which much of the fine restoration work on important documents is carried out. That staff will be augmented slightly.

But most of the other personnel will be used in preservation-type activities. For example, the main focus of our Preservation Program is what we call holdings maintenance, a very conservative program.

What it entails is taking existing records which are now in very acidic folders, which are terribly detrimental to their preservation, and in very acidic containers and removing them from these acidic folders and containers, of which many are over 50 years old, and putting them in acid-free folders, and new, acid-free boxes.

Quite frankly, I wish we could find a way to automate that process, but that just is not possible; you have got to have people going in the stacks, taking the documents out, and doing this work. The documents have to be unfolded, cleaned, and so forth. So the personnel are largely for preservation.

Senator ABDNOR. Does it take you long to train 76 people?

Dr. WARNER. It depends on the type of preservation they will be doing. If they are doing very skilled restoration work, yes, indeed, it does take a long time. In fact, there is only one really significant program for training people. It is at Columbia University right now, and that takes a lot of experience. These are hard people to come by; there is a demand for them.

On the other hand, lower-graded persons who are doing the reboxing, that does not take a lot of training. That work can be done fairly easily with lower-graded type personnel.

Mr. FONTAINE. Mr. Chairman, let me say that the 76 positions are part of the overall increase of 134 work-years. The work-year increase is a net number because there were some transfers from GSA for administrative people—personnel, payroll, finance. You will see a decrease later when you hear GSA's budget. So it is a net program increase.

Dr. WARNER. Thanks, Ray. That is helpful.

Mr. FONTAINE. And you will see the decrease later when you see GSA's budget.

KENNEDY LIBRARY IMPROVEMENTS

Senator ABDNOR. Very good.

Five hundred thousand dollars was spent on improvements at the Kennedy Library last year. What did these improvements entail?

Dr. WARNER. The $500,000 is to do some planning processes for further changes in that library. But also I think there were some examinations of the environmental control system in that library.

Perhaps, Ms. Weiher, you might want to add any additional details.

Ms. WEIHER. I think the $500,000 that you are discussing is the money set aside to hire a design and architectural firm to design the boat dock for increased access facility and the increased archival space. It will probably be two separate contracts.

As you may recall, the Congress appropriated $5.2 million; $4.7 million was deferred to 1986 and the $500,000 is to be the planning for this addition and the access.

Senator ABDNOR. I very well remember.

Ms. WEIHER. Yes.

Dr. WARNER. We all do.

Senator ABDNOR. It came on awfully fast. [Laughter.]

It was coming on all at once, not that the program was not meritorious, I suppose.

Ms. WEIHER. We had some thoughts about the process, also.

Mr. FONTAINE. We will go along with the deferral.

Dr. WARNER. I think we all share similar views on this one.

Senator ABDNOR. Are you going to be able to do it this year with this $4.7 million?

Dr. WARNER. It will not be spent this year, but since the money has been appropriated, it seems to us that it should be spent as wisely as possible, and that entails very careful planning. So what we will be doing this year is engaging in that planning process, so that hopefully what will emerge is a very functional building that will really meet not only immediate needs, but long-term needs that should solve the problem for our times.

Ms. WEIHER. We estimate it will take probably 36 months after design to complete the construction.

Senator ABDNOR. So no matter how fast they like to do things, it is a little difficult sometimes.

Ms. WEIHER. There are processes.

SLUC INCREASE

Senator ABDNOR. You are getting a SLUC increase, are you not? Has that been proposed?

Ms. WEIHER. The SLUC increase is very small. It includes $164,000 for a very small piece of expansion space in Waltham, MA. The increase this year is minimal.

Mr. FONTAINE. Basically, Mr. Chairman, the SLUC rates have been pretty much frozen in 1986 at the 1985 level for all agencies, unless they have expansion or additional space. But the rates themselves have remained stable.

PRESIDENTIAL LIBRARIES

Senator ABDNOR. The Presidential library actual costs are to be increased by what, over $4.5 million?

Dr. WARNER. Yes; that is exactly what we are talking about. Real costs do not increase much, but what you see in there, that jump, is the money for the Kennedy Library construction. Actual operation costs are very static.

Senator ABDNOR. I remember that.

Dr. WARNER. When I saw that budget item, at first I too was a bit puzzled, but I had it explained to me why it jumped.

GRANT FUNDING

Senator ABDNOR. It is reasonable; I guess that happens.

Now, grant funding has been eliminated, right?

Dr. WARNER. Correct.

Senator ABDNOR. What kind of an impact is that going to have on——

Dr. WARNER. That program, as you know, has been in existence a long time, and to eliminate the grants would have a significant and serious impact. Certain programs, for example, in the publications area would be terminated; projects such as the one at the University of Wisconsin which is dealing with ratification of the U.S. Constitution, a very important project as we get close to the bicentennial of that great event; another one would be some publications of some of the great figures of American history.

The publication projects on George Marshall, U.S. Grant, Jane Adams, and many others I could mention would come to an end if there were no grant funds. Also, there are certain archival assistance programs throughout the various States of the United States that will also not be funded because there would be no grants.

Senator ABDNOR. Well, do you think private funding is going to——

Dr. WARNER. I will be glad to address that. I think private funding has been very active. This has been an unusual program in that it has attracted considerable private funding, and also the fact that we do not give any overhead in that grant program, none at all, and that is very significant.

Many of the projects are matching funds with the institutions that get them. You give a university a small amount of money to start a university archives, say, and they will have to match that and give an ongoing commitment to continue the program. So it has been quite successful and we have attracted private money.

In all candor, however, I think that the greatest initiative and success has probably been expended in that area. Projects that are most appeal-

ing to private donors have received that funding and I think it would be very, very difficult to achieve more than modest success.

The whole area of competition for private funds has increased substantially. The efforts for private funding will continue. I am sure there will be some success, but I doubt very much if it could nearly approach the $4 million.

Senator ABDNOR. Some of your voices might be like mine; mine is gone. [Laughter.]

Dr. WARNER. I appreciate that courtesy.

COMMENDATIONS

Senator ABDNOR. I again want to say to you you are going to be missed and all your work has been greatly appreciated. I am sure they will somehow be getting you involved in here again. They are not going to let all that expertise go.

Dr. WARNER. Well, I will be very interested in the National Archives always, and I must say again to you, sir, that in our personal dealings and visiting in your office and appearing before the committee it has been a pleasure. I can only say that you have treated me with enormous courtesy and respect, and I appreciate that. It has been a pleasure always.

Senator ABDNOR. It has been our pleasure.

Mr. Scaboo, we hate to see you leave. Are you going to go back to the Sioux City area?

Mr. SCABOO. No; how did you know I was from Sioux City? [Laughter.]

Oh, it is in the bio.

Dr. WARNER. He really is retiring. I have got to go back to work somewhere else.

Mr. SCABOO. I am afraid that it has been too many years since I left Sioux City, IA.

Senator ABDNOR. It is still there.

Mr. SCABOO. It is still there, yes.

Senator ABDNOR. It is not far from South Dakota.

Mr. SCABOO. I am afraid I would call it Suicide City if I ever went back there. [Laughter.]

Senator ABDNOR. Since you have probably left there, we have put in the Missouri River and you no longer have floods.

Mr. SCABOO. You are right, that is correct.

Senator ABDNOR. That has been taken care of.

Mr. SCABOO. But I lived on a high bluff. [Laughter.]

Senator ABDNOR. Well, to all of you, we thank you very, very much.

Dr. WARNER. Thank you. It has been nice talking to you today.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. I have some other questions I think we will submit for the record.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

Question. What will happen if the Congress funds the grants but does not increase the base request for the administration?

Answer. If a specific line item for grants were included without additional funding, then the National Archives and Records Administration [NARA] would have to divert the planned preservation increase and other program funds to fund the Grant Program.

Question. Will the agency rely on GSA for any support after the separation?

Answer. NARA has entered into a reimbursable agreement with GSA for payroll and accounting services and for ADP and communications to support our personnel management data base. This is the most efficient and economical way to provide these services for the new agency.

Question. What agencies are your biggest customers? Is computer storage cutting into the load being placed on you? Will you see it have any impact in the future?

Answer. The largest users by far are the agencies in the executive branch of Government. Ninety-five percent of the records stored in the Federal records centers were retired by agencies and activities in the executive branch. Of these, the largest customers are Department of the Treasury, Department of Defense, Office of Personnel Management, and Department of Health and Human Services.

The Department of the Treasury is storing 4.1 million cubic feet of records in the records centers, including individual and corporate tax returns amounting to 3.4 million cubic feet. The records centers perform over 21 million reference requests for IRS each year from these records.

The Department of Defense is the next largest customer with 3.6 million cubic feet of records in the FRC system. The Military Personnel Records Center in St. Louis has over 71 million individual records documenting the military service of veterans, and responds to about 1.4 million requests a year. Also at St. Louis, the Civilian Personnel Records Center has over 61 million folders stored and serviced for the Office of Personnel Management and responds to more than 300,000 individuals and agencies that require documentation of Federal employment.

The Department of Health and Human Services is the third largest customer with over 1.6 million cubic feet of records in the FRC system including Social Security Administration active and inactive retirement and survivors insurance claims folders. The records centers perform about 4 million file actions for SSA on these records.

Virtually all of the other Federal agencies make use of the FRC system to some extent. The independent agencies store a total of over 2.4 million cubic feet of records in the records centers.

Computer storage has not yet had a significant impact on reducing the load placed on the FRC system by Federal agencies. It is difficult to predict the future impact on the FRC system. The increased use of nonpaper reporting and processing is in the area of records management which we call general administration or general correspondence records. While important, these types of records constitute only 5 percent of the collections that are transferred to the records centers. The vast bulk of records center collections consist of case files which have not lent themselves to large scale changeovers to a nonpaper medium. We do not expect this to change for several years.

There is one experiment being considered by the Internal Revenue Service to retain taxpayer information in computer generated form only that will impact the centers should it prove economically successful and if the courts will accept a computer generated document rather than the original document submitted by a taxpayer. The earliest it would affect the FRC system is at least 10 years away. As for other agencies, we do not expect any significant impact to be made on the FRC system by computer storage for the next 15 to 20 years.

Question. It is obvious that some libraries have more demands for information than others. I note that 93 work-years are devoted to trust fund activities. Of those, 48 are allocated for reproduction services, the rest are assigned by library. Who are these people and what are their responsibilites?

Answer. The 48 work-years for reproduction services represent trust fund central office employees engaged in a variety of work which increases the availability of NARS' holdings to other Government agencies, scholars, and the general public. Included are several administrative and accounting/cashier positions, positions that directly relate to document reproduction (via microforms, electrostatic copying, et cetera) and editing, marketing, and sales of trust fund products and publications.

The 45 work-years for Presidential libraries represent employees engaged in administrative, clerical, and sales work also designed to make the libraries' holdings and programs more available to other Government agencies, scholars, and the general public. Positions include museum/archival aids, audiovisual equipment operators, and sales clerks.

SUBCOMMITTEE RECESS

Senator ABDNOR. We want to thank each and every witness for appearing before the subcommittee. Your participation has been very helpful.

With no further business to come before the subcommittee, we are going to stand in recess until 10 a.m., Thursday, March 21. We are going to hear testimony from Dr. Don Devine, Director of the Office of Personnel Management.

Thank you very much.

[Whereupon, at 3:39 p.m., Tuesday, March 19, the subcommittee was recessed, to reconvene at 10 a.m., Thursday, March 21.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

THURSDAY, MARCH 21, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:15 a.m., in room SD–116, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, DeConcini, and Proxmire.

DEPARTMENT OF THE TREASURY

OFFICE OF PERSONNEL MANAGEMENT

STATEMENT OF DONALD J. DEVINE, DIRECTOR

ACCOMPANIED BY:

WILLLAM M. HUNT, ASSOCIATE DIRECTOR, ADMINISTRATION GROUP
JAMES W. MORRISON, JR., ASSOCIATE DIRECTOR, COMPENSATION GROUP
JEAN M. BARBER, ASSISTANT DIRECTOR FOR PAY AND BENEFITS POLICY, COMPENSATION GROUP
FRANK D. TITUS, ASSISTANT DIRECTOR FOR FINANCIAL CONTROL AND MANAGEMENT, COMPENSATION GROUP
SIDNEY M. CONLEY, BUDGET OFFICER

PREPARED STATEMENT

Senator ABDNOR. We will call this meeting to order.

We are called here to hear testimony from the Director of the Office of Personnel Management, Donald J. Devine. We are always happy to have you with us.

I will not put out a statement. We can do without that, and as late as I am, I think we will start right in hearing from you and your people. I know you have a lengthy statement, and I will assure you that it will be made a part of the record. You may proceed in any fashion you care to.

I understand more of the committee members will appear before too long, but please go ahead.

[The statement follows:]

STATEMENT OF DONALD J. DEVINE

GOOD MORNING, I AM PLEASED TO BE HERE TO DISCUSS WITH YOU THE OFFICE OF PERSONNEL MANAGEMENT'S BUDGET REQUEST FOR FISCAL YEAR 1986.

MY COLLEAGUES THIS MORNING ARE MR. JAMES MORRISON, ASSOCIATE DIRECTOR FOR COMPENSATION GROUP, MS. JEAN BARBER, ASSISTANT DIRECTOR FOR PAY AND BENEFITS POLICY, COMPENSATION GROUP, MR. FRANK TITUS, ASSISTANT DIRECTOR, OFFICE OF FINANCIAL CONTROL AND MANAGEMENT, COMPENSATION GROUP, MR. WILLIAM HUNT, ASSOCIATE DIRECTOR FOR ADMINISTRATION, AND MR. SIDNEY CONLEY, BUDGET OFFICER.

BUDGET SUMMARY

AS DIRECTOR OF THE OFFICE OF PERSONNEL MANAGEMENT, I BELIEVE IN A PRUDENT AND CAREFUL STEWARDSHIP OF ALL PUBLIC FUNDS PROVIDED TO US BY THE CONGRESS OF THE UNITED STATES. UNDER MY LEADERSHIP AT OPM, WE HAVE BEEN ABLE TO IMPLEMENT THIS PHILOSOPHY AND MAKE SIGNIFICANT INROADS IN REDUCING PROGRAM COSTS AND SAVING THE GOVERNMENT, AND THEREFORE THE U.S TAXPAYER, SIGNIFICANT SUMS WHILE MAINTAINING THE HIGH QUALITY OF OUR PRODUCTS AND SERVICES. IN S&E ADMINISTRATIVE FUNDS I HAVE REDUCED THE BUDGET BY 17.5% IN MY FOUR YEARS AND WHEN COMPARED TO THE PROPOSED BUDGET I INHERITED FROM THE PRIOR ADMINISTRATION, CONSIDERING PAY RAISES AND GENERAL INFLATION, THE SAVINGS INCREASE TO NEARLY $50 MILLION OR 33%. IN THE ENTITLEMENT PROGRAMS FOR WHICH WE HAVE FIDUCIARY RESPONSIBILITY, RETIREMENT, HEALTH AND LIFE INSURANCE, AS WELL AS PAY AND CLASSIFICATION MANAGEMENT, THE SAVINGS HAVE BEEN EVEN MORE SIGNIFICANT. BY THE END OF FY 85, WE WILL HAVE ACHIEVED SAVINGS OF $8.4 BILLION AND WE WILL ACHIEVE ADDITIONAL SAVINGS OF $25.6 BILLION BY FY 90. ALONG WITH THESE ACCOMPLISHMENTS, WE HAVE PROPOSALS PRESENTED IN THE CURRENT BUDGET, WHICH IF ENACTED, WILL SAVE AN ADDITIONAL $10 BILLION THROUGH FY 90, COMING TO A TOTAL SAVINGS OUT OF OPM MANAGED PROGRAMS OF OVER $44 BILLION. I AM PROUD OF THAT RECORD, AND IT IS IN THAT SPIRIT THAT WE ARE HERE TODAY REQUESTING AN APPROPRIATION OF APPROXIMATELY $6.1 BILLION FOR FY 86. OUR REQUEST IS MADE UP OF: $99.8 MILLION FOR SALARIES AND EXPENSES, $1.6 BILLION FOR PAYMENT TO THE EMPLOYEES HEALTH BENEFIT FUNDS, AND $4.4 BILLION FOR PAYMENT TO THE CIVIL SERVICE RETIREMENT FUND.

WE ARE ALSO REQUESTING A FISCAL YEAR 1985 SUPPLEMENTAL REQUEST OF FORTY MILLION NINE HUNDRED SIXTY FIVE THOUSAND DOLLARS ($40,965,000) FOR THE PAYMENT TO THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND AND A PROPOSED RESCISSION REQUEST OF $1,161,000 FROM OUR FY 85 S&E APPROPRIATION AND A NEGATIVE SUPPLEMENTAL OF $184,000 TO REDUCE THE LIMITATION ON THE TRANSFER OF TRUST FUNDS TO COMPLY WITH SECTION 2901 OF THE DEFICIT REDUCTION ACT OF 1984.

THE FISCAL YEAR 1986 SALARIES AND EXPENSES REQUEST REPRESENTS A 6.2% DECREASE FROM OUR FY 85 PROGRAM. THIS REDUCTION CONTINUES THE TREND THAT I HAVE ESTABLISHED SINCE I ASSUMED OFFICE. OUR REQUEST FOR FISCAL YEAR 86 REPRESENTS A 17.5% REDUCTION IN S&E EXPENDITURES AND A 22.6% REDUCTION IN PERSONNEL CEILING UTILIZATION SINCE FISCAL YEAR 81. ADJUSTING FOR SALARY INCREASES AND GENERAL INFLATION, OUR FY 86 REQUEST REPRESENTS A 29% REDUCTION FROM FY 1981 LEVELS. DURING THIS SAME TIME, I AM PROUD TO REPORT THAT WE HAVE ACTUALLY IMPROVED TIMELINESS AND SERVICE IN MOST AREAS. THIS WAS ACHIEVED BY INTRODUCING SOUND BUSINESS PRINCIPLES AND PRACTICES IN ALL ASPECTS OF OUR WORK. FROM THE BEGINING OF MY TENURE AS DIRECTOR, I CHALLENGED AGENCY MANAGERS AND EMPLOYEES TO BE COST CONSCIOUS AND TO LOOK FOR MORE EFFICIENT AND EFFECTIVE METHODS TO ACCOMPLISH OUR ESSENTIAL PROGRAMS AND SERVICES. I HAVE CONSISTENTLY ENCOURAGED CREATIVITY AND INDIVIDUAL INITIATIVE THROUGHOUT THE AGENCY. I BELIEVE THAT THIS APPROACH CONTRIBUTED TO THE SIGNIFICENT PROGRESS WE HAVE MADE OVER THE PAST FOUR YEARS AND HAS RETURNED RICH DIVIDENDS TO THE AMERICAN TAXPAYERS.

EVEN WITH THE SIGNIFICANT IMPROVEMENTS WE HAVE BEEN ABLE TO EFFECT TO DATE, THE JOB IS FAR FROM COMPLETE AND OUR FOCUS ON MANAGEMENT IMPROVEMENT MUST CONTINUE. IN FY 86 WE WILL IMPLEMENT A STREAMLINING AND CONSOLIDATION OF SOME OF OUR FIELD OFFICES AS WELL AS REDUCE OUR ADMINISTRATIVE OVERHEAD BY AN ADDITIONAL 10%. THESE CHANGES WILL FURTHER ENHANCE THE EFFICIENCY AND EFFECTIVENESS OF OPM OPERATING PROGRAMS. BY STREAMLINING OUR NATIONWIDE DELIVERY SYSTEMS AND ELIMINATING UNNCESSARY AND REDUNDANT OVERHEAD, OPM'S ABILITY TO FULLY AND EFFECTIVELY MEET ITS MANDATED MISSION REQUIREMENTS WILL BE ENHANCED NATIONWIDE. THESE CHANGES ARE CONSISTENT WITH SOUND BUSINESS

PRACTICES AND WILL PERMIT OPM TO CONTINUE MEETING ITS ESSENTIAL RESPONSIBILITIES AT A REDUCED COST TO THE AMERICAN TAXPAYERS.

IN ADDITION TO OUR S&E REQUEST, WE ARE SEEKING APPROPRIATIONS OF ONE BILLION SIX HUNDRED SIX MILLION ONE HUNDRED SIXTY FIVE THOUSAND DOLLARS ($1,606,165,000) FOR THE GOVERNMENT PAYMENT FOR ANNUITANTS, EMPLOYEES HEALTH BENEFITS AND FOUR BILLION FOUR HUNDRED SEVEN MILLION TWO HUNDRED THIRTY FOUR THOUSAND DOLLARS ($4,407,234,000) FOR THE PAYMENT TO THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND.

THE REQUEST FOR PAYMENT TO THE EMPLOYEE HEALTH BENEFITS FUND REPRESENTS THE GOVERNMENT'S SHARE OF HEALTH BENEFITS COSTS FOR CIVIL SERVICE ANNUITANTS AND SURVIVORS WHO DO NOT HAVE AN AGENCY TO CONTRIBUTE THE GOVERNMENT'S SHARE.

ONE OF THE BIGGEST PROBLEMS I FACED WHEN I BECAME DIRECTOR OF OPM WAS THE RUN AWAY COST OF THE HEALTH BENEFITS PROGRAM. AS YOU KNOW, I INTRODUCED A NUMBER OF COST CONTAINMENT PROVISIONS IN 1982 AND THEY HAVE ACHIEVED SIGNIFICANT SAVINGS, AVOIDING OVER $2.3 BILLION IN COSTS TO THE GOVERNMENT AND $1.3 BILLION IN COSTS TO EMPLOYEES, A TOTAL SAVINGS OF $3.6 BILLION THROUGH FY 84. ENROLLEES HAVE BEEN MAKING MORE INFORMED PLAN SELECTION AND OVERALL RESULTS HAVE BEEN VERY POSITIVE.

THE REQUEST FOR $4.4 BILLION FOR PAYMENT TO THE CIVIL SERVICE RETIREMENT FUND IS REQUIRED BY P.L. 91-93 (CIVIL SERVICE RETIREMENT AMENDMENT OF 1969) AND REPRESENTS THE CURRENT ANNUAL COSTS OF THE UNFUNDED LIABILITY CREATED BY INCREASES IN PAY OR LIBERALIZATIONS IN RETIREMENT BENEFITS ENACTED SINCE 1969, FUNDED OVER 30 YEARS.

HOWEVER, IN ADDITION TO THE $4.4 BILLION WE ARE REQUESTING FOR RETIREMENT FUND APPROPRIATIONS, THE 1969 LAW PROVIDES FOR ANOTHER PAYMENT, WHICH THIS YEAR AMOUNTS TO $9.2 BILLION AS PART OF THE PERMANENT INDEFINITE AUTHORITY, TO BE TRANSFERRED FROM THE TREASURY TO PAY JUST THE INTEREST ON THE STATIC UNFUNDED LIABILITY. WHEN THESE AND OTHER FINANCING CONSIDERATIONS ARE ACCOUNTED FOR, THE TOTAL COST TO THE TREASURY FOR THIS PAYMENT ACCOUNT FOR THE CURRENT RETIREMENT SYSTEM TOTALS ALMOST $15.7 BILLION DOLLARS. AND THIS PAYMENT DOES NOT INCLUDE $4.6 BILLION IN AGENCY CONTRIBUTIONS. THIS, OF COURSE, IS A HUGE SUM OF MONEY. BUT EVEN WITH THIS ENORMOUS ANNUAL PAYMENT OF OVER $15 BILLION

WE ARE NOT REDUCING THE UNFUNDED LIABILITY. WE ESTIMATE THAT THE TRUE UNFUNDED LIABILITY UNDER DYNAMIC ASSUMPTIONS EXCEEDS ONE-HALF TRILLION DOLLARS AND WOULD REQUIRE AN INTEREST PAYMENT OF $25 BILLION. SO, THE $15 BILLION PAYMENT DOES NOT EVEN COVER THE FULL INTEREST COSTS, MUCH LESS THE PRINCIPAL.

THE CONGRESS RECOGNIZED THAT IT COULD NOT CONTINUE SUCH A GENEROUS AND EXPENSIVE SYSTEM FOREVER, AND TWO YEARS AGO PLACED NEW GOVERNMENT EMPLOYEES UNDER SOCIAL SECURITY. WHILE THAT WAS A WISE AND MUCH NEEDED ACTION, IT HAD NO EFFECT ON THE 2.7 MILLION ACTIVE EMPLOYEES AND THE 2 MILLION ANNUITANTS OR SURVIVORS RECEIVING OVER $24 BILLION IN BENEFITS.

OBVIOUSLY SOME FURTHER ACTION IS NECESSARY TO BRING DOWN THE COST OF THE CURRENT SYSTEM TO MAKE IT AFFORDABLE AND MORE IN LINE WITH PRIVATE SECTOR PLANS. THEREFORE, WE HAVE PROPOSED LEGISLATIVE INITIATIVES WITH THIS BUDGET THAT WOULD SAVE THE RETIREMENT FUND $731 MILLION IN OUTLAYS IN FISCAL YEAR 1986 AND ALMOST $10 BILLION THROUGH FISCAL YEAR 1990. THE PROPOSALS INCLUDE:

- LIMIT COLA TO THE LOWER OF CPI-W OR GS WAGE INCREASE;
- LIMIT COLA TO 55% OVER BASE LIMITATION STARTING AT $10,000;
- POSTPONE COLA FOR ONE YEAR;
- REDUCE RETIREMENT BENEFITS BY 5% FOR EVERY YEAR UNDER AGE 65;
- CALCULATE ANNUITIES BASED ON HIGH 5 AVERAGE EARNINGS;
- ELIMINATE CREDIT FOR SICK LEAVE PHASED IN AT 20% REDUCTION PER YEAR;
- ELIMINATE MINIMUM ANNUITIES AND ADULT STUDENT BENEFITS;
- DELAY BENEFITS TO AGE 60 FOR SURVIVORS WITHOUT CHILDREN;
- EFFECTS OF 5% PAY REDUCTION ON CALCULATION OF HIGH 3 FOR RETIREMENT CALCULATION.

IN ADDITION TO THE REQUESTS FOR APPROPRIATIONS, I AM ALSO REQUESTING $52.8 MILLION IN TRANSFER AUTHORITY TO ADMINISTER THE ENTITLEMENT PROGRAMS. THIS REQUEST REPRESENTS A 3.7% INCREASE OVER FY 85 PRIMARILY TO COVER THE ESTIMATED COSTS OF REDESIGN OF THE AUTOMATED ANNUITY ROLL AND THE AUTOMATION OF ADDITIONAL RETIREMENT FUNCTIONS. THESE IMPROVEMENTS WILL ALLOW US TO MORE EFFICENTLY PROCESS THE ANNUITY ROLL SO THAT WE CAN BE MORE RESPONSIVE TO OUR ANNUITANTS AND MORE COST EFFECTIVE IN OUR INTERNAL OPERATIONS BY TAKING ADVANTAGE OF MORE MODERN AND EFFICIENT ADP PROCESSES.

BEFORE PROCEEDING WITH A MORE DETAILED REVIEW OF OUR FY 86 APPROPRIATIONS REQUEST, I WOULD ALSO LIKE TO EMPHASIZE AT THIS TIME THAT THE ADMINISTRATION STRONGLY SUPPORTS THE RETENTION OF THE GENERAL PROVISION, SECTION 513 OF THE APPROPRIATION REQUEST BEFORE THIS COMMITTEE, WHICH PROVIDES THAT "NO FUNDS APPROPRIATED BY THIS ACT SHALL BE AVAILABLE TO PAY FOR AN ABORTION, OR THE ADMINISTRATIVE EXPENSES IN CONNECTION WITH ANY HEALTH PLAN UNDER THE FEDERAL EMPLOYEES HEALTH BENEFIT PROGRAM WHICH PROVIDES ANY BENEFITS OR COVERAGES FOR ABORTIONS."

SALARIES AND EXPENSES

AS I MENTIONED EARLIER, I HAVE REPEATEDLY FOUND WAYS TO REDUCE COST AND SAVE MONEY IN OPM'S ADMINISTRATIVE BUDGET WITHOUT HARMING TIMELINESS OR QUALITY. I INHERITED FROM THE PREVIOUS ADMINISTRATION AN S&E BUDGET REQUEST OF $129.5 MILLION FOR FY 1982, TODAY I AM BEFORE YOU REQUESTING $99.8 MILLION. THIS $30 MILLION OR 23% REDUCTION WAS ACHIEVED EVEN WITH THE ANNUAL PAY RAISES AND GENERAL INFLATION THAT HAVE OCCURRED OVER THE LAST FOUR YEARS. WHEN THESE INCREASES ARE CONSIDERED THE SAVINGS ARE NEARLY $50 MILLION OR 33%. AT THE SAME TIME, AS OUR BUDGET WAS BEING REDUCED, WE WERE ABLE TO ACCOMPLISH MANY IMPROVEMENTS INCLUDING:

- REDUCE AVERAGE GRADE FROM A HIGH OF 8.8 to 8.3 AND IMPROVE THE SUPERVISORY RATIOS FROM 5.1:1 TO ALMOST 6:1 AN IMPROVEMENT OF OVER 17%
- CONSOLIDATE AND REDUCE THE NUMBER OF OPM PUBLICATIONS BY 33%, REDUCING PUBLICATIONS COSTS BY 52%
- REDUCE TRAVEL BY $350,000 OR APPROXIMATELY 15%
- ELIMINATE BACKLOG IN RETIREMENT CASES
- CLOSE REGIONAL PRINT PLANTS AND DOWNGRADE OUR CENTRAL OFFICE PRINTING FACILITY
- CENTRALIZE THE AGENCY'S PAYROLL OPERATIONS
- REDUCE OFFICE SPACE HOLDINGS BY 19%
- INITIATE COMPUTER MATCHING OF RETIREMENT RECORDS FOR DETECTION OF INELIGIBILITY AND FRAUD

THESE AND OTHER IMPROVEMENTS WERE ACCOMPLISHED BY INSTITUTING GOOD MANAGEMENT PRACTICES, STREAMLINING ORGANIZATIONAL STRUCTURES TO ELIMINATE

DUPLICATION AND TERMINATING NON-ESSENTIAL PROGRAMS. THE 22.6% REDUCTION IN EMPLOYMENT USAGE THAT WE ATTAINED WAS ACCOMPLISHED ALMOST ENTIRELY BY A MANAGED APPROACH TO JOB PLACEMENT AND NORMAL ATTRITION, MINIMIZING ANY ADVERSE EFFECT ON PERSONNEL.

OUR FY 86 BUDGET REQUEST IS A CONTINUATION OF OUR PAST TREND. WE ARE PURSUING SEVERAL INITIATIVES IN A MANAGED, PHASED IN APPROACH THAT WILL ALLOW US TO CONTINUE TO OPTIMIZE SCARCE RESOURCES AND TO SUCCESSFULLY PERFORM OUR STATUTORY REQUIREMENTS WHILE REDUCING OPERATING COSTS.

ENTITLEMENT PROGRAM ADMINISTRATION

OF THE TOTAL BUDGET I AM REQUESTING TODAY, OVER 98% IS FOR PAYMENTS TO THE HEALTH AND RETIREMENT TRUST FUNDS TO FINANCE THE FEDERAL EMPLOYEES BENEFIT PROGRAMS. WHAT WE ARE ABLE TO ACCOMPLISH IN SAVINGS IN THESE AREAS REPRESENTS THE REAL PAYOFF TO THE TAXPAYER. I HAVE DOCUMENTED PAST ACCOMPLISHMENTS IN THESE AREAS TOTALING SAVINGS OF OVER $4.7 BILLION THROUGH LEGISLATION AND ADMINISTRATIVE ACTION THROUGH FY 84 AND $23.5 BILLION THROUGH FY 90 FOR A TOTAL SAVINGS OF $28.2 BILLION. WHILE THIS IS SIGNIFICANT, MORE NEEDS TO BE DONE. THE FEDERAL RETIREMENT SYSTEM IS OVERLY GENEROUS - IT IS OVERLY GENEROUS IN TERMS OF EARLY RETIREMENT - IT IS OVERLY GENEROUS IN COLA PROVISIONS AND IT IS OVERLY GENEROUS IN TERMS OF COST TO MENTION A FEW AREAS. REDUCTIONS CAN AND SHOULD BE MADE. WE HAVE CREATED A MONSTER WITH A GROWING HALF A TRILLION DOLLAR UNFUNDED LIABILITY LEFT FOR FUTURE GENERATIONS TO WORRY ABOUT AND CONFRONT. THIS IS NOT A RESPONSIBLE APPROACH OR RESPONSIBLE MANAGEMENT. AS ALEXANDER TROWBRIDGE SAID OF OUR FEDERAL SPENDING, "A BILLION SECONDS AGO IT WAS 1951. A BILLION MINUTES AGO JESUS WAS ALIVE AND WALKING IN GALILEE. A BILLION HOURS AGO NO ONE WALKED ON TWO FEET ON EARTH. AND A BILLION DOLLARS AGO WAS 10.3 HOURS IN WASHINGTON, D.C."

I DO NOT BELIEVE THAT WITH THE FINANCIAL PROBLEMS FACING THIS GOVERNMENT THAT OUR EMPLOYEES ARE UNWILLING TO DO SOMETHING POSITIVE TO ASSIST IN THE SOLUTION. IF THE PROPOSED REFORMS WEREN'T NECESSARY AND FISCALLY RESPONSIBLE, IF THE TAXPAYERS DIDN'T WANT THEM AND DESERVE THEM - IF THEY WERE UNFAIR OR DRACONIAN MEASURES WE WOULD NOT BE PROPOSING THEM. A FEDERAL PAY CUT, AND CHANGES IN THE RETIREMENT SYSTEM TO MAKE IT MORE COMPARABLE WITH PRIVATE

SECTOR SYSTEMS, ARE NOT OUTRAGEOUS PROPOSALS. TRUE, NO ONE DESERVE A PAY CUT. BUT WITH DEFICITS OF $200 BILLION EVERYONE MUST MAKE SACRIFICES. I THINK FEDERAL EMPLOYEES UNDERSTAND THE SITUATION. I THINK THEY ARE WILLING TO SHARE IN GETTING THE COST OF GOVERNMENT UNDER CONTROL.

GENTLEMEN, WE MUST GET GOVERNMENT SPENDING UNDER CONTROL. I AM PRESENTING A BUDGET TO YOU FOR THAT PART OF GOVERNMENT SPENDING WHERE I HAVE SOME CONTROL - THE OFFICE OF PERSONNEL MANAGEMENT'S ADMINISTRATIVE COSTS AND GOVERNMENTWIDE ENTITLEMENT PROGRAMS, AND I THINK THIS BUDGET REFLECTS THAT GOAL. SOME SAVINGS WILL BE HARDER TO ACCOMPLISH THAN OTHERS, BUT THEY ARE ALL POSSIBLE AND I HOPE THAT WITH YOUR HELP THE NECESSARY LEGISLATION WILL BE PASSED TO BEGIN THE REFORMS NEEDED.

FY 85 RESCISSION PROPOSAL AND SUPPLEMENTAL

IN ADDITION TO OUR REGULAR FISCAL YEAR 1986 BUDGET REQUEST WE ARE ALSO BEFORE YOU TODAY TO TESTIFY ON OUR FISCAL YEAR 1985 RESCISSION PROPOSAL AND SUPPLEMENTAL REQUEST.

IN COMPLIANCE WITH SECTION 2901 OF THE DEFICIT REDUCTION ACT OF 1984 WE HAVE SUBMITTED A RESCISSION REQUEST OF $1,161,000 FROM THE OPM'S FY 85 SALARIES AND EXPENSES APPROPRIATION AND A NEGATIVE SUPPLEMENTAL OF $184,000 TO REDUCE THE LIMITATION ON THE TRANSFER OF TRUST FUNDS.

THE OPM'S SHARE OF THE GOVERNMENTWIDE REDUCTION TARGETS PROVIDED FOR BY SECTION 2901 OF THE DEFICIT REDUCTION ACT ARE BEING COMPLETELY MET IN THIS S&E RESCISSION REQUEST. WE CAN ACHIEVE THE SAVINGS REQUIRED THROUGH CONTINUED MANAGEMENT EFFICIENCY AND STREAMLINING OF OPERATIONS TO INCLUDE: REPLACING SCHEDULED TRIPS WITH MORE WRITTEN OR TELEPHONIC COMMUNICATIONS, REDUCING THE NUMBER OF TRAVELERS ON A TRIP TO THE MINIMUM ESSENTIAL TO ACCOMPLISHING THE MISSION, SUBSTITUTING LESS EXPENSIVE MODES OF TRAVEL AND LODGING, AND REDUCING THE NUMBER OF CONFERENCES AND MEETINGS AND THE NUMBER OF ATTENDEES SENT. IN THE PRINTING AREA WE WILL CONTINUE TO IMPLEMENT JUDICIOUS INVENTORY MANAGEMENT OF OUR EXISTING STOCKS OF STAFFING BROCHURES AND TEST MATERIAL, AS WELL AS CONTINUE TO CAREFULLY REVIEW ALL PUBLICATIONS AND LARGE PRINTING ORDERS IN ALL PROGRAMS TO ENSURE THAT WE ARE MOST EFFECTIVELY MEETING OUR ESSENTIAL MISSION REQUIREMENTS. IN ADDITION, AS DISCUSSED IN LAST YEAR'S BUDGET, WE ARE

CONTINUING TO MAKE GREATER USE OF GPO AND COMMERCIAL SERVICES TO TAKE ADVANTAGE OF ANY AVAILABLE COST SAVINGS THAT EXIST THROUGH CONTRACTING.

IN OUR NEGATIVE SUPPLEMENTAL REQUEST FOR THE TRANSFERS FROM TRUST FUNDS LIMITATION ALL SECTION 2901 REQUIRED SAVINGS ARE BEING MET WITH THE EXCEPTION OF PRINTING. THE OPM ADMINISTERS THE GOVERNMENTWIDE HEALTH BENEFITS PROGRAM AND DUE TO THE NEED TO PROVIDE HEALTH BENEFIT BROCHURES FOR OPEN SEASON TO ALL EMPLOYEES AND ANNUITANTS, IT IS IMPOSSIBLE TO MEET THE FULL PRINTING REDUCTION TARGETED FOR THE TRUST FUND. HOWEVER, WE WILL IMPOSE THE SAME STRICT TRAVEL REQUIREMENTS, AND RELY ON GREATER USE OF ADP TECHNOLOGY IN OUR TRUST FUND AUDITS TO MEET THE TRAVEL AND OTHER SAVINGS REQUIRED FOR THE TRUST FUND ACCOUNT.

AS YOU KNOW FROM MY RECORD, WE ARE COMMITTED TO ACCOMPLISHING THE MISSION REQUIREMENTS OF OPM AT THE LEAST POSSIBLE COST, AND WE LOOK FORWARD TO WORKING WITH THIS COMMITTEE IN THAT EFFORT IN THE FUTURE.

WE ALSO HAVE A SUPPLEMENTAL APPROPRIATION REQUEST OF $40,965,000 FOR THE PAYMENT TO THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND TO COVER THE UNFUNDED LIABILITY CREATED BY INCREASED PAY RATES UNDER E.O. 12477 AND P.L. 98-270. THIS FIGURE REPRESENTS THE AMORTIZATION OF THE SECOND OF 30 ANNUAL INSTALLMENTS AS REQUIRED BY PUBLIC LAW 91-93 TO FINANCE THE RETROACTIVE PAY ADJUSTMENT PROVIDED DURING FY 84.

THAT CONCLUDES MY OPENING REMARKS AND I WOULD BE GLAD TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Mr. DEVINE. Thank you, Senator Abdnor.

It is a pleasure to be here to go over our record of spending the taxpayers' money that you entrust to us. I am here with several colleagues. Their names are mentioned in my statement.

Senator ABDNOR. Pardon me. I welcome you gentlemen to the committee again. I am sure you are in good hands, Mr. Devine.

Mr. DEVINE. Thank you. I am proud of them too.

Under my leadership at OPM, we have taken very seriously our stewardship of the public funds provided to us. We have been able to make significant inroads in reducing program costs and saving the Government and, therefore, the taxpayers significant sums, while maintaining the high quality of our product and service.

In salary and expense administrative funds, I reduced the budget by 17.5 percent in my 4 years; and when compared to the proposed budget I inherited from the prior administration, considering pay raises and general inflation, the savings increased to nearly $50 million or 33 percent.

In the entitlement programs for which we have fiduciary responsibility—retirement, health and life insurance, as well as pay and classification management—the savings have been even more significant. By the end of fiscal 1985, we will have achieved savings of $8.4 billion, and we will achieve additional savings of $25.6 billion by the end of fiscal year 1990. Along with these accomplishments, we have proposals presented in the current budget which, if enacted, will save an additional $10 billion through fiscal 1990, coming to a total savings out of OPM managed programs of over $44 billion.

I am proud of that record, and it is in that spirit that we are here today requesting an appropriation of approximately $6.1 billion for fiscal 1986. Our request is made up of $99.8 million for salaries and expenses, $1.6 billion for payment to the employees health benefit fund, and $4.4 billion for payment to the Civil Service Retirement and Disability Fund.

We are also requesting a fiscal 1985 supplemental request of $40,965,000 for the payment to the Civil Service Retirement and Disability Fund, and a proposed rescission request of $1,161,000 from our fiscal 1985 S&E appropriation, and a negative supplemental of $184,000 to reduce the limitation on the transfer of trust funds to comply with section 2901 of the Deficit Reduction Act of 1984.

For the salaries and expenses request, there is a 6.2-percent decrease from our fiscal 1985 program. This continues the trend that we have established that I mentioned earlier. This represents a 22.6-percent reduction in personnel ceiling utilization since fiscal year 1981. During the same time, I am proud to report that we have actually improved timeliness and service in most areas. This was achieved by introducing sound business principles and practices in all areas of our work.

I have challenged agency managers and employees to be cost conscious and look for more efficient and effective methods to accomplish

our essential programs, and I am very proud of our people, that they have responded in a positive way to my request.

The job is far from complete. In fiscal 1986 we will implement a streamlining and consolidation of some of our field offices as well as reduce our administrative overhead by an additional 10 percent. We will also eliminate unnecessary and redundant overhead and meet other efficiencies nationwide.

ENTITLEMENT REQUEST

For the Government payment for annuitants, Employees Health Benefit Fund, we are requesting $1,606,165,000, and for the payment to the Civil Service Retirement and Disability Fund $4,407,234,000.

With the health insurance, this represents the Government's share of health benefits costs to annuitants and survivors who do not have an agency to contribute the Government share for them.

As you are aware, one of the biggest problems I had when I became Director of OPM was a $500 million shortfall in the Health Benefits Program. We have turned that situation completely around and have in a positive balance, and are building reserves. The bottom line is that we have avoided $2.3 billion in costs to the Government and $1.3 billion in costs to the employees, a total savings of $3.6 billion through our administration of this program.

The request for $4.4 billion for payment to the Civil Service Retirement and Disability Fund is required by Public Law 91-93, and represents the current annual costs of the unfunded liability created by increases in pay or liberalizations in retirement benefits since 1969, funded over 30 years, the so-called 30-year payment.

PERMANENT INDEFINITE AUTHORITY

I should note that in addition to that $4.4 billion, there is an additional $9.2 billion as part of the permanent indefinite authority to be transferred from the Treasury to pay just the interest on the static unfunded liability.

Senator ABDNOR. What is the permanent indefinite authority?

Mr. DEVINE. Public Law 91-93, the Civil Service Retirement Amendments of 1969 authorized the Secretary of the Treasury to transfer from general revenues annual payments into the retirement fund an amount equivalent to: (1) interest on the unfunded liability and (2) annuity disbursements attributable to military service. These amounts do not require annual action by Congress. I think that it is important that you realize that is part of the funding of this system.

The total cost to the Treasury then is about $15.7 billion over the funds that we administer, and that does not include an additional $4.6 billion in agency contributions. But even this enormous annual payment of over $15 billion for us and about $20 billion, including the agency payment, still does not put the fund on a sound financial basis. The true unfunded liability calculated under dynamic assumptions for the retirement fund exceeds one-half trillion dollars and would require an

interest payment of about $25 billion. So the $15 billion payment does not even cover the full interest costs, much less the principal.

LEGISLATIVE PROPOSALS

The Congress recognized that it could not continue such a generous and expensive system forever, and 2 years ago placed new Government employees under Social Security. While that was a wise and much needed action, it had no effect on the 2.7 million active employees and the 2 million annuitants or survivors receiving over $24 billion in benefits.

Obviously some further action is necessary. Therefore, the administration has proposed legislative initiatives with this budget that would save the retirement fund $731 million in outlays in fiscal 1986, and almost $10 billion through fiscal year 1990.

The proposals include a limit on the cost of living to the lower of the CPI–W or the general schedule wage increase so that the retirees are not doing significantly better than the employees; second, to limit the cost of living to 55 percent over base limitation starting at $10,000. That is basically the Social Security maximum. We pay the full COLA to that amount to make it equivalent with Social Security, and then 55 percent of the cost of living above that. We believe it is important to protect that base level as a kind of safety net similar to Social Security. Above that, it would be more similar to private sector plans, almost none of which pays 100 percent cost of living and very few of which pay on a regular basis at all, and very few pay at a 55-percent rate. We think it is generous while taking into account the fact of the different income needs.

Third, we would postpone the cost of living for 1 year. Next, we would reduce the retirement benefits by 5 percent for every year under age 65, again to make it more similar to normal retirement plans in the private sector and the overwhelming practice in the private sector—in fact, I do not know of any exception—that does not ask people who retire before the normal retirement to take an actuarial penalty for that early retirement.

Next we would calculate annuities based on the high 5-year average of the earnings rather than the high 3 years. Going back to the way it was calculated in the 1960's before the liberalization of that period.

Next, eliminate credit for sick leave which would be phased in at a 20-percent reduction per year. Again, the current practice is virtually unknown in the private sector.

We would also eliminate the minimum annuities and adult student benefits, similar to what they are in Social Security, and delay benefits to age 60 for survivors without children. In addition the 5-percent pay reduction affects the calculation of high three salaries, which would also reduce the cost of annuities.

I was pleased to see that the Senate Budget Committee adopted many of these recommendations, and I think that is a step in the right direction.

TRANSFERS FROM TRUST FUNDS

In addition to the requests for appropriations, I am also requesting $52.8 million in transfer authority to administer the entitlement programs. This represents a 3.7-percent increase over fiscal 1985, primarily to cover the estimated costs of redesign of the automated annuity roll, which has gotten severely outdated, and automation of additional retirement functions which are not automated at all, as well as payroll increases and so forth. These improvements will allow us to more efficiently process the annuity roll so that we can be more responsive to our annuitants and more cost effective.

ABORTION FUNDS

I would also like to emphasize at this time that the administration strongly supports the retention of the general provision, section 513 of the appropriation request before this committee, which provides that "No funds appropriated by this act shall be available to pay for an abortion, or the administrative expenses in connection with any health plan under the Federal Employees Health Benefit Program which provides any benefits or coverages for abortions."

MANAGEMENT IMPROVEMENTS

I would just like to close with one series of things that we have done to give you a better idea of the kinds of management improvements that we have adopted so that we can reduce our budget and, at the same time, maintain the quality and, in some cases, increase the quality of the product that we are offering.

We have reduced average grade by about 16 percent. We have reduced the costs of publication by 52 percent, and the number of them by 33 percent. We have reduced travel by 15 percent. We have closed our print plants in the regions and downgraded our central office printing facility. We have centralized the agency's payroll operations. We reduced office space holdings by 19 percent. We initiated computer matching of retirement records to detect ineligibility and fraud. We have eliminated the backlog in the retirement cases. One of the most serious problems we had with Congress when I came in was a 100,000 case backlog. It took us about 140 days to process an average claim and naturally that meant we received a lot of complaints. We have eliminated the backlog. We are now in a normal mode of processing about 25,000 cases, and we do them about 60 percent quicker than we did before.

Likewise, in our other big production operation in staffing we have been able to reduce the unit process costs for applicants and examinations significantly, even though we have reduced the resources. So the bottom line, I think, is that we can manage Government efficiently and we can save tremendous amounts of money if we take that obligation seriously, which we do at OPM, and we are proud of the record we have. And I would be happy to answer any questions you may have.

Senator ABDNOR. Well, thank you, Mr. Devine. You have given us a lot to think about. These figures are very impressive. That you can do all those things and still run a more efficient office is to be commended. These are staggering figures.

You tell us that you have actually improved efficiency. You obviously are getting more accomplished and more work done with those people. Is that a correct statement?

Mr. DEVINE. Yes, sir; and I appreciate your thanks very much.

Senator ABDNOR. We should put you all through the Government.

I see we have Senator DeConcini here. Welcome. We have been waiting for you to come.

Senator DECONCINI. I hope you did not wait for me.

Senator ABDNOR. Mr. Devine has just finished. I wish you could have heard him. Maybe you have looked at some of the figures in his statement.

Would you care to make an opening statement?

Senator DECONCINI. I have no opening statement, Mr. Chairman. When you are through questioning, I will ask some questions.

Senator ABDNOR. We will go back and forth with Mr. Devine. He is our only witness today so we have him all to ourselves.

Senator DECONCINI. You look in good shape, Mr. Devine.

RETIREMENT PROPOSALS

Senator ABDNOR. I was really interested that the civil service fund is how far behind? What was it you told me?

Mr. DEVINE. It is a little over a half trillion, $527 billion unfunded liability.

Senator ABDNOR. Of course, this committee does not have anything to say about those proposals you are proposing.

What committee does that come under? Yes; Government Affairs. So we will take our clue from them on what to do. They remind us many times that we give too much authorization. We will be very interested in following some of that.

What will the situation be if they make some of those proposed changes you are talking about? I certainly would not quarrel with the fact that is a serious problem we have here. Some day someone is going to be accountable. You are telling us that the interest would go onto that debt and would be greater than what we are actually putting into the fund this year.

Is that not right? Is that not what you said?

Mr. DEVINE. Yes, sir.

Senator ABDNOR. Fifteen billion dollars versus $25 billion. That is what the interest would be if we were paying it out?

Mr. DEVINE. Yes, sir.

Senator ABDNOR. Do you think it is possible to make changes? Again, it is not this committee's jurisdiction, and I should not be asking that, but I cannot imagine what is going to happen when we start changing the rules of the ball game for those already under the retirement pro-

gram. We changed Social Security, I understand that, and that is justified. I guess we probably need to look at this all the way through, Social Security, the military, all kinds of retirement because it is a huge, huge problem.

But trying to change the rules, I remember one year where we cut off Social Security and made a minimum benefit. And I remember another time we had drawn a line and said starting here on in, people in Social Security will get $100 less, and we are still getting reports on that.

We wish you luck. It is going to be a tremendous challenge and battle.

PERSONNEL REDUCTIONS

You have had a 22.6-percent reduction in personnel ceiling utilization since fiscal year 1981.

Mr. DEVINE. Yes.

Senator ABDNOR. You can make these cuts. You have already made how many over those 4 years?

Mr. DEVINE. We had about 8,100 employees when I came in. We have about 6,500 now.

Senator ABDNOR. So you have actually cut almost 25 percent?

Mr. DEVINE. Yes, sir.

Senator ABDNOR. And instead of curtailing your efficiency, you have increased your efficiency?

Mr. DEVINE. I think we literally found that by having too many people, they were inhibiting the productivity. They were getting in each other's way and creating paper problems where there were not any real problems. So by cutting it down, we actually got more people focused on the real work of the organization.

Senator ABDNOR. That is good. I guess you improved your productivity. You are getting the job done and you are efficient. You have caught up with your backlog and I have no quarrel with that.

Are you going to do most of this by RIF's, this reduction?

Mr. DEVINE. No, sir; we expect to do most of it by attrition. There may be some RIF's, but we expect to do most of it by attrition.

Senator DECONCINI. Mr. Chairman, may I just ask Mr. Devine a question if the chairman would yield?

What is the amount of attrition normally? How many do you have in 1 year? Are there any figures on that? What can you probably expect to have in 1 year just by attrition if you follow it?

Mr. DEVINE. About 10 percent per year.

Senator DECONCINI. How does that vary with what you are projecting here?

Mr. DEVINE. Well, 200 would be much smaller than that.

Senator DECONCINI. Much smaller than 10 percent?

Mr. DEVINE. It would be well under.

Senator DECONCINI. It would be under 10 percent?

Mr. DEVINE. Yes.

Senator DECONCINI. Thank you.
Thank you, Mr. Chairman.

VOTING RIGHTS OBSERVATIONS

Senator ABDNOR. You surprised me that OPM is responsible for voting rights observations. I guess there are cases that are directed to you by the Justice Department. Is that a real costly activity for you?

Mr. DEVINE. Well, mainly it is unpredictable. This is a strange kind of case. When they set up the Voting Rights Act in the first place, they were concerned that if the Justice Department, conducted the observations, it would look like a police force doing the registration. So they wanted to get an agency that did not have that kind of law enforcement aura to do it. We provide observors, but have no control over the number of people because that is determined wholly by the Department of Justice. We just send the people out. So our greatest concern with the program is that it is something that we cannot manage and plan for since Justice will tell us we need to have so many people to do this on such and such notice.

We have over the past 2 years worked better with them, and we have been getting more advance notice than we had before.

Senator ABDNOR. It is almost like an orphan. It looked to me like it did not fit. Maybe it would be a good efficient operation, and I bet you would have better ideas how to handle it if you had your way about it.

Mr. DEVINE. I do think the theory is sound. When we are getting into something as sensitive for local and State government and sending registrars into counties and registering people to get on the rolls, I think it makes some sense to have an agency that does not go there like a police force with weapons but just acts as an independent registrar. So it is kind of a strange arrangement and it does put a little strain on us to anticipate the workload, but I think it is something we can live with.

Senator ABDNOR. You used the people out of Justice, they provide the bodies?

Mr. DEVINE. No; we provide the people. They are not necessarily all from our agency. If we cannot staff it because we have too many other demands, then we will go to other agencies. But we basically provide the people.

Senator ABDNOR. We are looking at this matter of S&E payments. You are reducing yours apparently.

Is that because of the personnel dropping all the time?

Mr. DEVINE. Yes; they are basically based on personnel levels and, therefore, we can reduce them.

Senator ABDNOR. You are still following that 135?

Mr. DEVINE. Yes.

Senator ABDNOR. Very good.

Mr. DEVINE. We have not achieved it but are on target with the deadline.

Senator ABDNOR. Senator DeConcini.

Senator DECONCINI. Thank you, Mr. Chairman.

Mr. Devine, I want to talk about voter registration. In a letter dated February 7, 1985, Mary Rose, assistant director for executive and personnel policies, asked the State of Texas for voluminous documents on their voter registration drive last fall.

Paragraph 3 of that letter notes that notwithstanding your opposition to enforcing the Intergovernmental Personnel Act, "Congress has urged on the Director certain activities toward ensuring compliance with the statutes and regulations."

Therefore, she was following up on State conducted voter registration.

Director Devine, here is a copy of that law which you are probably familiar with, which is Public Law 98–472. The continuing resolution, on page 98, middle of the page, says, "It is the sense of the Congress that, one, voter registration drives should be encouraged by governmental entities at all levels and, two, voter registration drives conducted by State governments on a nonpartisan basis do not violate the provisions of the Intergovernmental Personnel Act," and then it cites the statute.

My question, of course, is why then would a member of your staff insist on enforcement of provisions in light of congressional intent and what are you going to do in the future?

Mr. DEVINE. Well, as I understand that, and we have looked at this, that sense of Congress does not override our obligations under the law. However, I do not disagree with those statements as a sense of the Congress as far as they go.

Our obligation, however, is to find out whether, in fact, the voter registration drives are on a nonpartisan basis and that other aspects of the Intergovernmental Personnel Act are not violated.

As you correctly noted in your preface to the question, it is an act that I do not support. I do not think that the Federal Government has any business running the personnel systems or the registration systems of the States other than under the Voting Rights Act we talked about before, which is a totally different thing. I do not think we should be in there.

I would like Congress, instead of putting in a sense of Congress that voter registration drives are encouraged and that ones that are nonpartisan do not violate, I would prefer they put in a simple section of the law that says the Intergovernmental Personnel Act of 1970—is over and then there would not be any question about this.

Senator DECONCINI. Maybe that is a fair criticism of Congress. It seems to me that the sense of Congress is, I thought, a pretty clear directive to the Executive of two simple things. One is to encourage voter registrations. Overkill in statements by Mary Rose certainly would not encourage voter registration.

It goes further. It says, "The voter registration drive conducted by State governments on a nonpartisan basis does not violate the provisions of the Intergovernmental Personnel Act."

Would you suggest we pass a law saying that voter registration on a nonpartisan basis is exempt from the Intergovernmental Personnel Act? Is that your recommendation?

Mr. DEVINE. Well, again, as far as this statement goes, I have no argument with it, but does that mean that nothing else that is done in a voter registration drive—if something very wrong happened that was on a nonpartisan basis, if they were excluding people from voting on a nonpartisan basis, it would still be wrong and against the law. I mean as far as the statement goes, I have no argument against it, but we are not investigating to find out whether it is not done on a—that if it is done on a nonpartisan basis, that there is something wrong with it. Of course it is not if it is on a nonpartisan basis.

What we have to do is to look, is there anything else going on that is against the Intergovernmental Personnel Act.

INTERGOVERNMENTAL PERSONNEL ACT

Senator DECONCINI. Well, in doing that in the Texas case, the documents and information that you require they send to you included some of the copies of all State authorities permitting the State to establish a voter registration program, including statutes, Executive orders, and regulations; written instruction to State officials for carrying out the voter registration program; outlines of any training programs used to instruct State employees in carrying out the program of voter registration, examples of forms, identification cards, posters, instructions to the registrants, any agreements made with the counties or cities under the Executive order, and copies of any newspaper articles on the subject. It goes on to name another seven or eight: names and addresses of all Government buildings at which State voter registration drives have been conducted, showing the dates and hours during which voter registration programs have been conducted over the past 5 years; names and addresses, titles, and telephone numbers of persons authorized to determine the use of each of these buildings, and a description of the State voter registration program establishing how safeguards in the system are designed.

Mr. Devine, you are not going to tell me you need all of this information to encourage voter registration and see if they comply with that act, are you?

Mr. DEVINE. Well, but the Intergovernmental Personnel Act has a lot of things in it that we are required to find the answers to, and those questions relate to them. Again there is nothing in there that says we do not encourage voter registration nor that we do not believe that nonpartisan conduction of such drives is appropriate.

Senator DECONCINI. Can you show me anything in the Intergovernmental Personnel Act that says you need to have the names and addresses of all Government buildings at which State voter registration drives have been conducted; showing the dates and hours during which voter registration programs have been conducted over the past 5 years; and the names and addresses, titles, and telephone numbers of persons

authorized to determine the use of each of those buildings? Is that in that act?

Mr. DEVINE. Well, one of the things we would have to find out to comply——

Senator DECONCINI. Is that in the act?

Mr. DEVINE. With the sense of Congress, to find out if it was nonpartisan is obviously to know where the activities are being conducted so that we can investigate to find out if, in fact, they were done on a nonpartisan basis.

Senator DECONCINI. Are these requirements spelled out in the act?

Mr. DEVINE. No, sir

Senator DECONCINI. My point, and I hope it is clear, is that I think it has been overkill and I think it is an affront to the democratic process. And for whatever motives, I object to it, and I am going to do everything I can to try to persuade the chairman that we write a stronger sense of the Senate or whatever we need so you do not do that.

It seems to me if you are interested in enforcing that act, you could do it by sending someone to the State of Texas or the entity that is doing the registration, ask some questions and not ask them all these things. If I were in business or government, and I got all these things, I would give up registration. I would say, my God, it is not worth it. Obviously OPM does not want us to be involved in registration because they are asking us all these silly questions and asking us to file voluminous amounts of material. It really is an insult, in my opinion, for the executive branch to be discouraging voter registration.

I know from talking to the President that he supports voter registration, and I just wonder if he knows what kind of operation you have been conducting. Maybe he does. Maybe you can tell me that, yes, he stands behind this 100 percent, but I doubt it.

Mr. DEVINE. Well, I support registration too. My life has been in politics. I have been a professor of political science. I have always supported open access to voter registration and voter registration drives. That is not the question at all.

The question is whether course of activities are undertaken by State government employees operating under grants by the Federal Government. That is the question, and we cannot find out if, in fact, that is the case if we do not know where those activities took place, to refer to the precise question you have.

I would ask if you are interested in dealing with this, that rather than a sense of Congress and the terms of the language that is there, again I do not disagree with anything you said in that sense of Congress. If you want to do something, and something I would be very supportive of, if you would put in a legislatively binding prohibition from going in and investigating these things, you would not only have my cooperation but my approval.

Senator DECONCINI. Well, Mr. Devine, you begged the question in my mind because the sense of the Senate or the Congress is to promote registration. It does not say that you are not supposed to enforce the law.

But to me, asking for these 14 items does not promote registration, especially when you are asking for all of the locations and the names and the titles of people over the past 5 years. You do not need that to determine whether you are enforcing that law. You need to know, obviously, a few places where the registration drive was conducted and some of the people involved so you can talk with them and a few of the Government employees. But you do not need to know for the last 5 years, every address, title, and telephone number of persons authorized to determine use of that building. You are not going to need a list of every building in the State of Texas or in the counties. I just hope you will modify the position that OPM has taken.

Mr. DEVINE. Well, the position—that is a guideline of questions to go out and ask. Obviously, if the State says we cannot give you everyone of them or we can only give you them for 1 or 2 years or whatever that they have, the point is not to be overly requesting information. And at this hearing is the first time I even heard of that questionnaire. It does sound a little over——

Senator DECONCINI. That would be helpful.

I yield, Mr. Chairman.

Senator ABDNOR. Senator Proxmire.

PREPARED STATEMENT

Senator PROXMIRE. Thank you, Mr Chairman.

I have a statement which I would like put in the record.

Senator ABDNOR. Without objection, your statement will be put in the record at this point.

[The statement follows:]

STATEMENT OF SENATOR WILLIAM PROXMIRE

Mr. Chairman, this subcommittee has not always agreed with all of the policies of Director Devine or the Office of Personnel Management over the past 4 years. But there is no question that Dr. Devine has done a good job of holding down the cost of his agency's operations.

According to his testimony, if the President's 1986 budget and initiatives are adopted, OPM will have achieved savings of over $44 billion in both direct spending and entitlement programs under management by OPM. OPM's direct appropriation for salaries and expenses will have dropped from $129.5 million in fiscal 1982 to $99.8 million next year—a drop of nearly $30 million or nearly 23 percent.

But a statistic that casts a shadow over this fine accomplishment is t[illegible] the estimated, true unfunded liability in the current Federal could exceed one-[illegible]alf trillion, that's trillion, dollars. Contained in the overall OPM budget accounts for n[illegible]xt year is $9.2 billion as part of the permanent indefinite authority to be transferred from the Treasury to pay just the interest on the static unfunded liability. On top of this there is $4.4 billion in direct appropriations to the Civil Service Retirement Fund and $4.6 billion outside of the OPM budget that is contributed by Government agencies to cover their people. So it is clear that we have a massive deficit on our hands and large interest payments to be made.

Mr. Chairman, hopefully we can learn from Dr. Devine what his secret is regarding holding down OPM's S&E costs, while at the same time, find out what the prognosis is for the Federal retirement system.

Thank you.

OFFICIAL RECEPTION AND REPRESENTATION

Senator PROXMIRE. Mr. Devine, I am going to ask you a couple of questions on very small expenditures and then the biggie a little bit later.

First, OPM is requesting a new $2,500 item for official reception and representation expense. Given that, we face an extraordinary budget crisis, and we are all aware of that, why should the committee approve that expense?

Mr. DEVINE. I think it is important——

Senator PROXMIRE. It is new. We have not had it before.

Mr. DEVINE. It is not new. It was taken out by the House last year and, therefore, that is why it looks like it is new. It has been in there for many years at about the same monetary level. The reason that it is in there, and I think it is important, is that many activities take place in Government for which you cannot use normal appropriations. But I think every Member of Congress would support them.

For example, one of the things that is supported or has in the past been supported out of that activity, but this year we will not be able to do, is that we are in charge of the handicapped employee awards of the year, and traditionally we have had a reception for the winners and their families at OPM. This program took about $700 out of that $2,500. It was a nice thing. It was positive. We are trying to build some positive morale in the Government, to recognize the contribution many handicapped individuals make to the Government.

The normal expenditure of funds are not allowed for spending for coffee and punch and cake and things like that to have a nice kind of reception which takes place in my office.

Likewise, we do a similar kind of thing for veterans. We have a women's program that we are in charge of for the Government and so on. Most of the expenditures are, in fact, on receptions for programs that we administer. Some of it is representational for me. I think that is important too. No executive in the private sector would be expected to have no ability to pay for a lunch or something like that if he goes out. I think it is very useful. I have lived without it this year. I am probably going to have to raise privately the amount of money for the handicapped and veterans and women's groups and so forth. I can live with it that way, but I do not think that it is very much money, and I think it does some good.

Senator PROXMIRE. I realize that and I agree with you. It would be helpful if, for the record, you could give me $500 for the handicapped and you could also break it down for veterans, women's, and whatever other purposes.

[The information follows:]

Fiscal year 1984 reception and representation expenses

Veterans preference commemoration reception	$600
Executive leadership awards reception	300
Handicapped Federal employees awards reception	700
Meritorious service awards reception	200
Miscellaneous expenses including official luncheons, flowers, et cetera	700
Total	2,500

ENTERTAINMENT EXPENSES FOR PCEE

Senator PROXMIRE. The second question is this. OPM is also proposing to set aside $12,000 for the entertainment expense of the President's Commission on Executive Exchange. Once again, that appears to be—I may be wrong—but it appears to be a new item.

Is it and why is it needed at this time and who will spend the money?

Mr. DEVINE. The Commission, is actually autonomous from us, while we do administrative work for them. But I do happen to know the reason for that because I am also a Commissioner on that Commission.

These are moneys which are raised from the private sector, and they go through the Government because it is necessary for the funds to go through the Government. This is an exchange program where the private sector sends their executives into Government for experience in the Government, and the Government executives go out to the private sector so they can better understand each other's problems. I think it is a very positive program where the Government can learn from the private sector and the private sector can learn the problems of the Government.

The money is collected from the private sector, but it does have to go under the law through the Government. That is why it appears there as an expenditure, but it is actually not public money.

Senator PROXMIRE. All $12,000 is collected from the private sector?

Mr. DEVINE. Yes, sir.

Senator PROXMIRE. I do not think that is a new account.

Mr. DEVINE. Last year it was set up for the first time because of the change in the law.

TRAVEL INCREASE

Senator PROXMIRE. The OPM budget shows an increase for travel and transportation of from $1,460,000 in 1984 to $2,225,000 in 1985. This is more than a 50-percent increase from 1984.

Then $2,427,000, another 10 percent, in 1986. Why shouldn't the committee cut this request back to the 1984 level and save about $1 million?

Mr. DEVINE. We are asking for a rescission as part of our budget request today also. I believe it is about $1.1 million Is that right?

Mr. CONLEY. That is the total rescission.

Mr. HUNT. Travel is $338,000 of that amount.

Senator PROXMIRE. That is in 1985. That would not explain the 10-percent increase in 1986.

Mr. DEVINE. In 1986, it is again the voting rights travel that I was discussing with the chairman before, that we provide the personnel for the Department of Justice. In fact, you may remember last year we had to get a supplemental appropriation to deal with this because of unanticipated demands that the Justice Department made on us.

Again, this is a very unusual situation where one agency is directing another agency's staff. If you wish to restrict that, the way it should be done is to ask or require the Department of Justice not to ask us to send the observers to the counties to do the registration.

FEDERAL EMPLOYMENT CONTRACT

Senator PROXMIRE. The President said he is opposed to changing the military retirement system because of contractual obligations, which I think is a very good point. However, can you explain why that should be so for the military service and not for the civilian service?

Mr. DEVINE. As I understand it, the military retirement, the President has emphasized that there is a different kind of situation that exists for the military than the civilian, and I believe that is the case both in terms of the substance of what they do—we do not ask by and large, although there are some exceptions and they have different treatment under the retirement system, we do not by and large ask Federal employees to go into combat situations.

Senator PROXMIRE. You do not ask military employees, by and large, to go into combat except a very small percentage.

Mr. DEVINE. They are all potentially riflemen, as I was taught.

Senator PROXMIRE. You are pulling my leg. Maybe 5 percent, 10 percent.

Mr. DEVINE. I know when I went in they said whatever your MOS is, your basic MOS is infantryman.

Senator PROXMIRE. That is the justification as you see it?

Mr. DEVINE. Well, that is in terms of what they do. But in terms of straight analysis of personnel needs, it is a question of supply and demand to me.

The fact of the matter is that we have a turnover rate of voluntary resignations in the Government which runs around 4 percent for the civilian service. For the Marine Corps, that runs about 33 percent. So, in terms of the different demand, we have extreme differences between the two, and in terms of the supply.

In the military——

Senator PROXMIRE. Let me interrupt to say you are making a very logical and perhaps persuasive argument, that many people would buy in the free market concept.

I am talking about the contract argument that the President made, that when these people went into the military, they had at least an implied contract they would get a retirement at a certain level. They serve 20 years in the military and get out and get one-half their pay. There is

certainly the same kind of implied contract, no difference, with somebody who works for the Federal Government in civil service.

Mr. DEVINE. I had said many times I will make a deal right today that I will give the retirement benefits to those people who are ready to retire today, the same retirement benefits they had when they came in. If we did that, we would save much, much more than our proposals would save under retirement because, of course, most people who are starting or who will be eligible to retire did not have cost-of-living adjustments when they started, they did not have the high three but the high five, they did not have retirement at age 55. These and many others were added since most of those came in.

So if there is an implied contract when you came in, that is an implied contract I would be very willing to honor. But the fact of the matter is all that does is show that a contract in an employment situation—and I think what the President is trying to say is military service is something of a qualitatively different nature than a normal employment contract, that in an employment contract situation, obviously the conditions of employment differ, depending upon the economic conditions that exist in the society around us.

In the twenties and thirties in Government we had low pay and we had low retirement. In the sixties we vastly increased all the benefits in the retirement system without putting in the funds for them, I might add. The go-go sixties, Government coming in, everything going up and up. Now we are in a different period. We are in the eighties and, we have a tremendous unfunded liability in our retirement system. We have got a whole different environment, and like any employer in the private sector, we have got to look at our employment situation and be in tune with the times.

In today's times in terms of today's market, and you mentioned a lot of people who would agree and a lot would disagree, but the way I look at this as a manager, as a business manager, is in terms of how many people are leaving and what is the line coming in. The fact of the matter is the military meets their goals by the month. They have an even Q line of supply and demand. On the civilian side, we have 10 people waiting to get into every job. It is a totally different situation, both in terms of what they do, that is qualitatively as the President was talking about, and quantitatively as I look at this as a business manager.

IMPACT ON UNFUNDED LIABILITY OF RETIREMENT PROPOSALS

Senator PROXMIRE. Just one final question, Mr. Devine. It relates to what you have just been talking about.

You estimate that the true unfunded liability for the Federal retirement system will exceed $500 billion, one-half of a trillion next year, and this deficit would require a huge interest payment on top of the contributions made to the fund by other agencies.

You indicate, on page 5 of your statement, that a number of reforms are being proposed by the President to deal with what you believe is an overly generous retirement system.

Looking at your proposals, I would be surprised if we got one-half of them enacted this year. What are the short-term and long-term effects if the Congress does not pass some or all of these proposals like rolling back COLA and limiting benefits? How close are we from a Federal retirement financial crisis like the one that has plagued Social Security? Is it 1 year away or 2 years away?

Mr. DEVINE. No, sir; it is probably into the next century, the beginning years of the next century. It is not an immediate problem in terms of being unable to pay the benefits, and even that could be fixed by increasing the Government payments into the system. After all, they are at the level of $15 billion now. Increasing them somewhat would not be that radical.

Even if all our proposals were adopted, they would only decrease the unfunded liability from $500 billion to about $400 billion. We are asking for a very modest bite at this enormous problem. I was very encouraged by the Budget Committee vote. We did make some admittedly tough decisions, and Congress dealt with a good number of them. Not enough of them I think, but a good number of them. I think that there is a tremendous obligation for Congress to look very, very closely at this program. Even if we adopted every one of our proposals, we would still have a retirement system that would be as good or better than anything in the private sector. It is still a very, very sound system. We have a phasein at 10 years to effectuate these changes on the age change, and the Congress did make a change in the age in Social Security. Of course, Social Security started from 65 and then slowly, I think, to age 68.

Remember, our basis is at 55. That is 10 years lower than where you started at Social Security. I just think we have got to take some action in that area.

Senator PROXMIRE. Thank you, Mr. Devine.

Mr. Chairman, I have a couple more questions for the record.

REDUCTION IN GRADES 11 THROUGH 15 BAND

Senator ABDNOR. Fine. We are about through. I have one question which I feel is very important, one that this committee has been very concerned about.

You have implemented a program to reduce Federal employment in grades 11–15. I want it made clear that I have supported and will continue to support Federal work force reductions where they make sense. However, I must add that I am concerned about across-the-board actions of any kind. I am especially concerned about the impact on law enforcement agencies. Many agents are at the GS–11 level and, frankly, I do not believe these positions can or should be reduced.

Using the Secret Service as an example, well over 50 percent of the personnel in the agency fall within those grades. What is your reaction to that?

Mr. DEVINE. We have developed a very sophisticated statistical model to look at the different situations that exist in different agencies. Al-

though the basic program is an across-the-board one within agencies, we have different targets depending upon the kind of mission they have and the occupational mix that they have.

Now, even with our attempts to be very sophisticated about that, the numbers that come out of the statistical model are not necessarily translated directly into changes in the work force because the agencies still have an appeal to OPM and they have an appeal to OMB in this. So I believe that the program is set up to be flexible enough to take into account needs that are different. So I think that we can deal with unique problems such as the one you mentioned.

Senator ABDNOR. Very good, because I have no quarrels with the administrative end of it. It makes a lot of sense, but these agents in the Secret Service and some of our customs agents make a career out of this, and with the value of their job, it makes sense not to try to judge that by how many number of people are at different levels because these are all rather unique situations. So I am pleased to hear you say that.

Senator DeConcini.

Senator DECONCINI. Thank you, Mr. Chairman.

I have several questions to submit for the record.

COMBINED FEDERAL CAMPAIGN

Let me ask one other question.

Last year the subcommittee had to deal with the issue of listing eligible groups for the combined Federal campaign because the plan put forward by your office was, we thought, unworkable. We came to some accommodation, and this subcommittee assumes that the provisions set forth last year in the Treasury, Postal Service appropriation bill regarding listing organizations and providing the 25 word description of the organization will continue this year. Will it be necessary to intervene and ensure that it does?

Mr. DEVINE. I think that the program worked well under those instructions last year, and I would not change them except for one thing. We have an appeal before the Supreme Court on this whole procedure. As you may remember, we have been kind of backed into this whole procedure from the first place by court orders. If we prevail in that Supreme Court case, and I have not made a decision and, in fact, I have not even looked at it seriously, but if we win the court case, we may restructure the program again, and this might become an issue.

I will say I will be happy to keep in touch with you and your staff to let you know if that, in fact, comes about. But I would say, yes, just flat out—with this one caveat—that if we win the suit, we may go back and look at the whole question of how that is structured.

Senator DECONCINI. I recognize the independence of your agency from the legislative branch, but we might be able to work out something without having to put it in the law. I will be more than happy to try to work with you because I have a particular interest in this and I appreciate that offer.

Along the same line, have you considered reinstating the computer numbers along with the names and descriptions of the organizations to facilitate your own disbursal of funds? You did away with that last year or the year before.

Mr. DEVINE. I pride myself on knowing details, but that is one I do not.

Senator DECONCINI. My understanding is that each name is printed in full instead of using the employee computer number. The problem seems to occur when the complete name is not included and the transfer is not made. Is that correct?

Mr. DEVINE. That I do know about. There are still numbers on them.

Senator DECONCINI. There are?

Mr. DEVINE. You only write them in if it is one that is not listed. Under the old rule, you just could contribute to the ones on the list. Under the new rules, you can write in, so obviously if they are not on a list, then you would write them in and there would be no number.

Senator DECONCINI. Thank you.

Thank you, Mr. Chairman.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Thank you, Senator DeConcini.

I think we have a few more questions we would submit in writing.

Mr. DEVINE. Certainly.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

RETIRED EMPLOYEES HEALTH BENEFITS

Question. Retired employees health benfits are projected to be $642,000 below the fiscal year 1985 level. To what is this reduction attributed?

Answer. The Retired Employees' Health Benefits [REHB] Fund was created by the Retired Employees' Health Benefits Act of 1960 and is the source of financing for health insurance held by pre-1960 retirees. Those retirees currently in the Retired Employees Health Benefit Program thus represent a closed population that is quite aged and has a relatively high mortality rate. The reduced level of resources in fiscal year 1986 reflects the steadily declining population of retired employees health benefits enrollees.

REDUCTION IN CIVIL SERVICE RETIREMENT AND DISABILITY FUND

Question. There is a reduction indicated in the Government contribution to the Civil Service Retirement and Disability Fund. Is this reduction dependent upon legislation being enacted? If it is and the legislation is not enacted, how will the contribution be affected?

Answer. The President's fiscal year 1986 budget display for the payment to the Civil Service Retirement and Disability Fund includes a separate legislative schedule reflecting a reduction of $62,426,000. This reduction is the estimated savings that will accrue to this appropriation account should all of the legislative proposals pertaining to the Civil Service Retirement and Disability Fund be enacted. These savings are presented separately as reductions to the appropriation requested under current law that would be realized if the proposed legislation were enacted. Therefore, if the reforms are not enacted, there should be no effect on the normal appropriation request for this account.

Questions Submitted by Senator William Proxmire

Administrative Services

Question. Dr. Devine, when Senator DeConcini and I introduced S. 469, a bill approving the President's package of administrative cost rescissions mandated by the DeConcini amendment to the Deficit Reduction Act, there were loud howls at the agencies all over town. After more than 27 years in the Senate, I have learned that agencies would rather give up entire programs than get rid of a few travel dollars, or a limousine, or consultant and study money.

Yet I notice that your agency has reduced administrative services costs from $7.2 million and 187 slots in 1984 to $4.5 million and 124 slots next year—a cut of about 37 percent in dollars over 3 years. How have you been able to achieve this magnitude of administrative cost savings and still maintain essential OPM services?

Answer. We have significantly reduced our administrative costs by eliminating duplication and overlap in organizational structures, developing more efficient delivery systems, enhancing productivity, and eliminating nonessential programs. We have taken actions to centralize and streamline our payroll system and reduce our printing costs. We are reducing our administrative overhead by an additional 10 percent in support of the administrative policy to reduce costs. In addition, the reductions reflect savings for position management in the grade 11 to 15 band and the proposed 5 percent reduction in Federal pay.

Motor Vehicles Savings

Question. Your justifications do not contain the traditional object class data which shows how much you spent last year on travel, other services, printing and publication, and so forth.

However, according to the explanation of OPM's response to the Deficit Reduction Act section 2901 rescissions, you were unable to achieve any savings in operation, maintenance, management, leasing, acquisition, and disposal of motor vehicles. You did meet your other goals, for cuts in travel and the other four categories of savings. Why were you unable to make any savings in motor vehicles as part of the deficit reduction exercise, or perhaps you did and the House document containing the explanation is incorrect?

Answer. OPM does not operate or maintain its own motor vehicles. Rather, we rent or lease them from GSA or private companies. OMB's instructions were to include rental or lease costs not under motor vehicles but under the category of travel of personnel. Therefore, the savings shown in the travel category equal 100 percent of the S&E rescission requirements for both travel and rental of motor vehicles.

Reductions in Director's Office

Question. What specific cuts have you applied to your own personal Director's Office operations, both in dollars and staff, since you came on board at OPM 4 years ago?

Answer. Since I have been Director of OPM the staff assigned to the Director's Office has been reduced from 25 people in fiscal year 1980, to 17 currently. This represents a 30-percent reduction and has been achieved through both reorganization and attrition. Although, it is difficult to draw an exact comparison for dollar reductions due to pay raises, general inflation and reorganizations, the S&E budget for activity 7, executive services, which includes my office, has been reduced from $9.8 million in fiscal year 1981 to $7.4 million in the fiscal year 1986 request. This $2.4 million reduction was made in nonessential administrative and overhead costs, and represents a 24.5-percent reduction in real dollars and significantly more if measured in fiscal year 1981 dollars.

QUESTION SUBMITTED BY SENATOR DENNIS DECONCINI

COMBINED FEDERAL CAMPAIGN

Question. I understand that the Supreme Court recently heard a case regarding CFC. Have you made any contingency plans if you should win, and also if you should lose?

If you win, have you come up with criteria for traditional health and welfare organizations?

Answer. You are asking about *Devine* v. *NAACP Legal Defense and Educational Fund, Inc.*, No. 84–312 (United States argued February 19, 1985). We have no firm plans regarding what we will do when the decision is announced. Certainly we were unable to discern from the course of the actual argument before the court how the court will rule and we have thus thought it inappropriate to speculate on the outcome.

To the extent that we have any plans, they are necessarily very general. If the decision against the Government is overturned, we will try to hew as closely as possible to Executive Order 12353, charitable fundraising (March 23, 1982). The regulations promulgated at 48 Federal Register 34910 were a good faith effort to implement the Executive order and may well be the model for any of our future efforts. They contain examples of how we have attempted to define traditional health and welfare organizations.

If the decision goes against the Government, we will model our future efforts on the regulations promulgated at 49 Federal Register 32735 (August 16, 1984). These regulations were crafted to conform as closely as possible to the order of the court of appeals in the *NAACP* case. Future rulemaking, if any, will of course provide for notice to the public and opportunity to comment. We necessarily take this process very seriously and, because of the importance of the public comments, we believe it would also be inappropriate to speculate on the precise nature of the final regulations.

SUBCOMMITTEE RECESS

Senator ABDNOR. I want to thank you, Dr. Devine, and all you fellows and lady for your fine testimony. We appreciate your telling how it is, and we again commend you for your fine testimony today.

With that, we will stand in recess until Tuesday, March 26, I believe at 2 o'clock, when we are going to be hearing from the Postmaster General and Assistant Secretary of Treasury for Administration on the various Department activities.

I say again, in the last few days we have had some excellent testimony and some fine reports from the various agencies, and yours is one of the better ones. Thank you very much.

[Whereupon, at 11:15 a.m., Thursday, March 21, the subcommittee was recessed, to reconvene at 2 p.m., Tuesday, March 26.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

TUESDAY, MARCH 26, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–116, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and Proxmire.

U.S. POSTAL SERVICE

STATEMENT OF POSTMASTER GENERAL PAUL CARLIN

ACCOMPANIED BY:
MRS. JACKIE STRANGE, DEPUTY POSTMASTER GENERAL
BILL CUMMINGS, SENIOR ASSISTANT POSTMASTER GENERAL FOR FINANCE
LEWIS A. COX, GENERAL COUNSEL, U.S. POSTAL SERVICE

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order.

Today we continue our fiscal year 1986 budget hearings and our witnesses will be Paul Carlin, Postmaster General of the United States; Joe Bishop, the Deputy Assistant Secretary—Administration—for Operations; Mrs. Carole Dineen who is Fiscal Assistant Secretary; and Mrs. Katherine Ortega, Treasurer of the United States.

Frankly, I have no opening statement. I have a hunch Senator Proxmire might want an opportunity.

Senator PROXMIRE. I have no opening statement. I must say you have a fine group of witnesses lined up here. I know Mr. Carlin is a distinguished public servant, and I am honored to have him here. I apologize for having to leave for the floor in a moment but I will be back.

Senator ABDNOR. This is Mr. Carlin's first time with us. He was recently appointed Postmaster General and I must say my meetings with you have been most productive and I look forward to a long-working relationship with you as Postmaster General. You are probably familiar with this operation even though you have not appeared before us. I know you have a statement, maybe a lengthy one. You can go ahead in

any manner you care to. If you wish to submit your entire statement for the record it will go in that way. You may introduce the people with you.

INTRODUCTION OF ASSOCIATES

Mr. CARLIN. I am accompanied here at the table on my far left by Mrs. Jackie Strange who is the Deputy Postmaster General. To my immediate left is Mr. Bill Cummings, Senior Assistant Postmaster General for Finance, and to my right Lewis A. Cox, General Counsel. I have a relatively short statement and, with your permission, I will read it.

We welcome the opportunity to participate in this hearing.

BUDGET REQUEST

Mr. Chairman, for fiscal year 1986, the President has recommended an appropriation for the Postal Service of $39,128,000. This is a reduction of $1,100,381,000 from the amount that was appropriated by the continuing resolution for fiscal year 1985.

TRANSITIONAL APPROPRIATION

Our transitional appropriation request is $39,128,000 for fiscal year 1986.

PUBLIC SERVICE APPROPRIATIONS

We have not received a public service appropriation since fiscal year 1982 and even though we would be authorized $460 million for this year, we are not requesting one.

REVENUE FORGONE

For the first time, this budget year, the President has recommended no appropriation for revenue forgone due to statutory requirements for free mail and reduction of certain postage rates. The Office of Management and Budget plans to submit legislation to repeal the authorization for revenue forgone appropriations and revise the reduced-rate statutes. As required by law, the budget transmits the fiscal year 1986 revenue forgone request prepared by the Postal Service under existing authorizations. The total funding required to maintain free and reduced-rate mail at authorized levels for fiscal year 1986 would be $980,933,000 under current law. This amount would maintain the reduced rates on the 16-step rate-phasing schedule at step 14 until July 6, 1986, when that phasing would move on to step 15, pursuant to the original phasein schedule.

Under current law, if Congress decides not to provide the full appropriation, the Postal Service will adjust the reduced rates to make up the shortfall. Illustrative statements have been provided in advance of the hearing and are attached to my testimony.

Because reduced rate mailers do not bear all of the increase, the change in rates will enlarge the gap between the subsidized and the unsubsidized rate levels over the remainder of fiscal year 1985. Accordingly, an additional appropriation of $168,620,000 is needed for revenue forgone on free and reduced-rate mail based on the new rate schedules for the rest of fiscal year 1985. This supplemental is not requested in the President's budget.

POSTAL SERVICE GOALS

Mr. Chairman, since I am newly appointed in this role, it might serve well for me at least for the record and for yourself to furnish you some of my managerial philosophy.

My thrust will be to instill a strong will to manage among our postmasters, supervisors, and managers throughout the organization. The underlying emphasis that I will be bringing will be a serve-the-customer approach. In doing that, we will purposely move in three directions at one time.

First, we will move from being a product-oriented organization to one which is customer driven.

Second, after providing central policy direction, we will provide maximum operating latitude to the lowest organizational level possible. Third, we will treat people right at all levels. We are purposely going to be shifting within the organization from a climate which has existed for much too long where managers have an orders-giver orientation, rather than a facilitating/coaching approach. We will be emphasizing this type of direction for all of our managers and supervisors by identifying, training, and rewarding those people who can develop human potential. I intend to put people first—our customers and the people who work for the organization—so that we provide services which are prompt, reliable, economical, and friendly. That encompasses the management philosophy I will be bringing to do the job. I will be happy to answer any questions you may have.

TOTAL POSTAL EMPLOYEES

Senator ABDNOR. That is a noble goal and I commend you. You have fine people working for you under your leadership. I know you will inspire them to do that because the customer is the one we must pay the most attention to, and I know that effort will be appreciated by everyone in the country.

How many people are in the Postal Service.

Mr. CARLIN. 717,000. Approximately 90,000 of those people serve in noncraft areas, either as postmasters, supervisors, managers, technical, supervisory, or secretarial people.

Senator ABDNOR. Will that number stabilize? Has there been a constant growth in personnel? I know you have gone to electronics and electronic equipment. What has been the case in numbers?

Mr. CARLIN. There were 742,000 at the time of the postal reorganization. Through attrition, our work force was reduced to 670,000. Now, with the large increase of mail volume in recent years, it has come back up to 717,000.

EFFECT OF RATE INCREASE

Senator ABDNOR. There has been a noticeable drop in mailing because of the increased rates. Did you see any appreciable drop in that when you went to 22 cents? Does that mean some people are a little less likely to mail?

Mr. CARLIN. As we analyze our rate increases over the rate cycles in the early years, there was a very sharp dip which lasted for some time. With each succeeding rate increase, the dip has been less and the period of time that volume has decreased has been less. We have only had 4 or 5 weeks since the most recent rate increase, but volume is maintaining at almost the same level it was, which is very encouraging to us.

At the time of postal reorganization we were handling 86 billion pieces of mail. During fiscal year 1984 we handled 131 billion pieces, and handled it with about 30,000 fewer people. Although we have automated equipment, I would give credit to our people and to the commitment that is brought to the job by our people and to the type of skills brought by our managers, supervisors, and postmasters.

Senator ABDNOR. On April 17, the Postal Service increased postal rates. While nobody likes to increase the rates, they are necessary in order that the Postal Service can use statutory mandate for computerization. Can you tell us more about the increase, the magnitude of it, and how the customers have reacted to it. When can we anticipate another increase? I have asked you a lot of questions.

Mr. CARLIN. There was a 2-cent increase for the first-class stamp, which represented a 10-percent increase. The increase for all of the classes of mail approximated 9 percent across the board. It was about 3¼ years since the last increase for first-class mail.

Senator ABDNOR. What was that increase then? Was that about a 10-percent increase?

Mr. CARLIN. There was a two-step increase. The last one went from 18 to 20 cents and prior to that it was 15 to 18 cents.

Senator ABDNOR. Have you had any complaints about the rates going up or do people understand they have had to go up?

Mr. CARLIN. The number of complaints we received this time was relatively minor. I think what that reflects is an appreciation on the part of our customers that we are achieving rate stability. Even more important, larger mailers have had a chance to do some long-range planning and we built some credibility with them over this extended period of time.

Senator ABDNOR. How many years or months are involved?

Mr. CARLIN. Barring any abnormal, external increases in our costs, we should be able to go 3 to 4 years before another increase. Inflation

plays a big part. Eighty-three percent of our costs go for personnel-type costs, for salaries, fringe benefits, and the like. The rate of inflation has a very large bearing on our costs.

PRESIDENT'S BUDGET PROPOSAL

Senator ABDNOR. If the President's budget proposals were adopted, what effect would they have on the Postal Service generally and what would they mean to postal rates? Would it be necessary to increase sooner than projected if the President's budget proposals were adopted? Will that have any great effect on the overall operation, or would it change your projection of maybe being able to go 3 or 4 years down the road? Will the President's budget have any effect on your planning?

Mr. CARLIN. The President's budget proposes essentially two things; first, there would be no money appropriated for revenue forgone appropriations and second, the Postal Service would be required to increase its contribution to the Civil Service Retirement Fund.

After bringing the phasing to step 16, the residual impact on the Postal Service would be $723 million for revenue forgone and $266 million in the first year for the increased contribution to the Civil Service Retirement Fund. We are talking about $1 billion of unanticipated cost between those two items. The impact would change us in fiscal year 1986 from a planned surplus of $692 million to a deficit status of $305 million. This would place us in a situation where we would have to request a rate increase sooner than we would otherwise have anticipated, maybe even as early as the end of the current fiscal year.

Senator ABDNOR. Would you be able to absorb those?

Mr. CARLIN. If we absorbed the proposals, the effect would be as I have stated.

RATE SCHEDULE FOR FISCAL YEAR 1986

Senator ABDNOR. We appreciate the chart you have put together.

Could we just review that chart for a moment and explain what each column represents. There is no mention of free mail for the blind and physically handicapped. Can you tell us what happens to the rate of those mailers, if the President or the Budget Committee's recommendation is adopted. Neither one of them carries that forgone.

Mr. CARLIN. Coming down the first column on the left-hand side are the three categories that are covered by preferred rates. The second-class publications have five breakouts, third-class nonprofit has three, and there's the fourth-class, library rate.

Looking at the columns across, the one headed old step 14 prices, were the rates that were in effect prior to the February 17 increase.

The column headed new step 14 prices are those rates which are currently in effect. The new step 15 prices are those rates that would go into effect pursuant to the regular phasing after July 6, 1986.

The next two columns headed $801 million and $500 million make two assumptions. The first one, $801 million appropriation, makes the assumption that the funding would be held to the fiscal year 1985 level

of appropriations. If that were done, you can see in the various categories what the impact would be. $500 million is a partial number arbitrarily set between $800 million and zero.

The OMB proposal is implicit, in that the bottom line would change the funding for the preferred rate mailers from the taxpayer to the ratepayer. In addition, it provides for regular rates for in-county mailers, and all of the other preferred prices would be increased to step 16.

The column on the far right, the regular commercial rates, is the full commercial rate for each of those categories which includes both the contribution to the attributable costs as well as to the institutional costs.

Senator ABDNOR. What is the 172?

Mr. CARLIN. The 172 is the percentage increase compared to the present 4.8 cent in-county rate. If you look over to the left, under new step 14, the current price is 4.8 cents.

Senator ABDNOR. That is a 173-percent increase?

Mr. CARLIN. To move it to the full commercial rate would be a 173-percent increase.

SenatorAbdnor. What happens if you do nothing until the year 1986?

Mr. CARLIN. The commercial rates would go into effect if there were a failure of appropriations.

Senator ABDNOR. Do you mean it could happen?

Mr. CARLIN. Yes.

Senator ABDNOR. That would be the cost?

Mr. CARLIN. That is correct.

Senator ABDNOR. It could have a great effect on many of our societies.

What is in-county?

Mr. CARLIN. In-county is primarily for newspapers that are distributed within a single county. What we have attempted to provide for the committee's guidance are various scenarios of what the impact would be under the major preferred mail categories.

Senator ABDNOR. That is a very revealing chart.

FREE MAIL PRIVILEGES

Mr. CARLIN. One point I did not comment on which you asked me about was mailing for the blind and the visually handicapped. While we have not seen the legislation as submitted from OMB, it is our understanding that that category would be the responsibility of the Postal Service. The cost there is $38 million, which includes mail for the blind as well as $1 million for overseas voting.

RURAL DELIVERY

Senator ABDNOR. You will find I am very parochial as chairman of this subcommittee and I always have to ask about service to rural areas. I am sure you anticipated that. I think, given the composition of this subcommittee, you can appreciate why we get into this line of questioning. As a Senator from a rural State, believe me, there is no more important aspect of the service than to the rural areas.

Does the Postal Service plan to maintain service to rural areas?

Mr. CARLIN. The Postal Service shares the concern you have for mail to rural America. We also have a strong belief people should not be penalized because they choose to live in a rural area. We have no plans to reduce the service to rural areas.

POST OFFICE CLOSINGS AND 6-DAY DELIVERY

Senator ABDNOR. We have to have people living in rural America. They make a great contribution to the country and our whole economic makeup. Sometimes people have a tendency to forget that. We like to take advantage of saying where we are coming from and get that in the record.

Do you anticipate doing away with 6-day delivery or the wholesale closing of small post offices?

Mr. CARLIN. This past year, our volume grew from 119 billion pieces to 131 billion pieces. I don't know of any way we could deliver that if we did not have 6-day delivery. We have no plans to do away with 6-day delivery.

As far as closing post offices, we will look at them individually. We have no plans for any wholesale closing of post offices.

FIRE AT POSTAL HEADQUARTERS

Senator ABDNOR. Last fall, you experienced a massive fire at the headquarters building. What was the impact of the fire on your operations and are you back to normal?

Mr. CARLIN. We had extensive damage on our ninth floor. We had some water and smoke damage which was very severe on a portion of the 10th floor and a portion of the 8th floor. During that period, it did not impact on our main mission which is delivering the mail. Thanks to the efforts of some people who worked around the clock for almost 3 weeks including a firm brought in from the outside, elevator, maintenance, and other specialty people, we were able to have many of our people back in the building and operate normally several weeks after the fire. We do have some small units which are those primarily located on the ninth floor who are located elsewhere. We will have some of those relocated into the building sometime in the middle of April and we anticipate the remainder of them will come sometime during the early fall.

PUBLIC SERVICE APPROPRIATIONS

Senator ABDNOR. I commend you and your people for the way you have handled that. We can appreciate the type of disadvantage you were in.

More than $460 million was authorized for public cost and no money requested. Can you absorb the public service cost? For the last few years, what would the public service cost be if it were appropriated for fiscal year 1986?

Mr. CARLIN. If appropriated as authorized it would be $460 million. If you go back, in fiscal year 1982 we received approximately $12.1 million instead of what was authorized. This was our last public service appropriation. If you take fiscal years 1982, 1983, 1984, 1985 and add those funds the Postal Service could have asked for, it totals $2.1 billion. There would be another $460 million authorized for each of the fiscal years 1986, 1987, and 1988.

TRANSITIONAL COSTS

Senator ABDNOR. That $39 million requested to cover only transitional costs occurred before the reorganization; is that correct?

Mr. CARLIN. That is correct.

REVENUE FORGONE COMPONENTS

Senator ABDNOR. How much of the $981 million originally requested for revenue forgone is for fiscal year 1986 and how much is the reconciliation for the previous years? Can you tell me that?

Mr. CARLIN. Yes, I can; if you give me a minute.

The true total for revenue forgone for fiscal year 1986 would be $1.016 billion. In prior years, we would have come to you asking for money for a reconciliation adjustment. This year it works the opposite way. We owe you back $35 million, so the difference between those two results in our revenue forgone request of $981 million.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. I am very pleased to have that. We might have a couple of questions or at least one we will submit and have you reply in writing, if you don't mind. If the other members have questions, we will submit those, too. Otherwise, we thank you for a very splendid first time appearance, and we look forward to a lot of them. We both belong to Sigma Chi. Thank you very much.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTION

Question. I understand that one possible solution to the revenue forgone question would be a scenario that goes like this: Take all of the preferred rate mailers, those that are presently subsidized, to the end of phasing, step 16, and from that point forward have their rates determined by the Postal Rate Commission. Would you care to comment on this proposal?

Answer. Over the past several weeks, many suggestions have surfaced concerning how to deal with nonprofit and preferred rates in the future. A few have proposed the total elimination of the revenue forgone appropriation and an increase for all nonprofit and preferred rates to step 16 on the current phasing schedule. This would result in all of those rates recovering their own attributable costs, but would not address the issue of the continuing portion of the revenue forgone appropriation; that is, the contribution to the overhead costs of the Postal Service which nonprofit and preferred rates are exempt from making. The administration has proposed that regular rate mailers be required to make this contribution through their rates, and has indicated that it will transmit legislation to the Congress to accomplish this. Not having seen the final draft

and not knowing how the shift of this cost burden would be accomplished, the Postal Service is not in a position to comment except in very general terms. However, the present system for supporting nonprofit and preferred rates has worked well, in that decisions on matters of broad public policy and fiscal responsibility have been made in the public arena by the elected representatives of the people. The Congress ought not to change such a process without careful consideration.

QUESTIONS SUBMITTED BY SENATOR ROBERT C. BYRD

Question. Mr. Chairman, I am seriously concerned that the U.S. Postal Service continue to maintain small rural post offices and 6-day postal delivery services. In the past, the Postmaster General has indicated to the Senate Appropriations Committee his willingness to participate in economies—but pledged not to close small rural post offices or eliminate 6-day mail delivery in the process.

Because these Postal Service matters are so important to rural States, such as those you and I represent, I will again this year urge that the subcommittee include an amendment in the bill which would prohibit the use of appropriated funds to close small post offices or discontinue 6-day delivery service.

Mr. Carlin, what are your views on maintaining the extensive delivery network that makes the Postal Service unique, and do they differ from those of your predecessor? What are your views on the Grace Commission regarding the closing of thousands of small post offices?

Answer. Senator, I can assure you that my views on the need to maintain the physical delivery network which makes the Postal Service such an effective communications medium closely parallel those of the former Postmaster General. The Postal Service has no plans to engage in wholesale closings of post offices. Indeed, tinkering with what makes the Postal Service unique in pursuit of false economies would not serve postal customers well. That is not to say that from time to time the Postal Service will not seek to close a post office when it is no longer required and where the customers can be offered equal or better service by alternate means. Nevertheless, the Postal Service does not plan to accelerate such closings beyond approximately the numbers that have been closed in any of the last few fiscal years. In keeping with this general position, the Postal Service disagrees categorically with the recommendations of the Grace Commission, and the General Accounting Office before it, that the Postal Service close thousands of small post offices. Postal management has long believed that it is inappropriate to judge the worth of a particular post office to the mail delivery network solely on the basis of the revenues taken in by that office.

Inasmuch as the Postal Service has no plans to close numerous small post offices and no plans to reduce mail delivery days—in part because heavy mail volumes make a smaller delivery week a bad idea and in part because it is already prohibited by Public Law 98-369 from doing so—an amendment to the annual appropriations bill to prohibit this action would appear unwarranted.

Question. Mr. Carlin, I understand that the Postal Service, based on clarifying remarks by Chairman Abdnor in the Congressional Record, has instituted certain safeguards and procedures in those instances where the Postal Service believes that a post office must be closed. Would you elaborate for the record on the safeguards the Postal Service uses in these selected cases?

Answer. Title 39, United States Code, section 404(b) provides that the Postal Service must give persons served by a post office proposed for closing or consolidation at least 60 days notice of such a proposal and provide those persons with an opportunity to present their views. The Postal Service must consider the effect of a closing or consolidation on the community and the employees, the requirement in the Postal Reorganization Act that there be a maximum degree of service to rural and small communities, the potential cost savings, and other relevant factors. A decision to close or consolidate a post office must be in writing, must recite the Postal Service's findings, and must be available to the individuals served by that office at least 60 days prior to the proposed closing date. Any person served by the office may appeal the Postal Service's decision to the Postal Rate Commission within 30 days after it is available. The Commission

must review the decision on the basis of the record before the Postal Service and may suspend the proposed closing until it renders its final decision. No later than 120 days after such an appeal is filed, the Rate Commission may set aside the Postal Service's decision to close or consolidate a post office if it finds that the Service acted arbitrarily, without following the required procedures, or in the absence of substantial evidence on the record.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF JOSEPH E. BISHOP, DEPUTY ASSISTANT SECRETARY (ADMINISTRATION) FOR OPERATIONS

ACCOMPANIED BY:

CAROLE J. DINEEN, FISCAL ASSISTANT SECRETARY FOR THE BUREAU OF PUBLIC DEBT AND FINANCIAL MANAGEMENT SERVICE
W.M. GREGG, COMMISSIONER OF THE PUBLIC DEBT
KATHERINE D. ORTEGA, TREASURER OF THE UNITED STATES FOR THE U.S. MINT AND SAVINGS BOND DIVISION
DONNA POPE, DIRECTOR OF THE MINT
WILLIAM E. DOUGLAS, COMMISSIONER, FINANCIAL MANAGEMENT SERVICE

OPENING REMARKS

Senator ABDNOR. Our next witness is Joe Bishop, the Deputy Assistant Secretary, Administration for Operations of the Treasury. He and his colleagues will discuss the various financial and new strain of activities operated by the Office of the Secretary; accompanied by Carole Dineen, Fiscal Assistant Secretary and Katherine D. Ortega, Treasurer of the United States. You both have opening statements. You may proceed in any way you like. The statements will be placed in the record.

Before we begin I would like to note the Office of Assistant Secretary for Administration is in a state of flux at this time because nominations have yet to be confirmed. However, I do want to note that operations are proceeding smoothly. I want to thank all of you for being here today, for keeping things on an even keel during the transition.

I would be remiss if I did not publicly thank Terry Golden for an exceptionally well-done job during his tenure as Assistant Secretary. We enjoyed working with him. Our working relationship was excellent, and I believe the Treasury Department has made tremendous strides for modernization during his watch. We look forward to working with him in his new capacity as the Director of the General Services Administration.

I want to welcome John Rogers who is in a new position as Terry's replacement. He is not new to the subcommittee's realm. During his tenure in the Executive Office of the President as Special Assistant, we had a fine relationship with him.

Ladies and gentlemen, you may proceed in any manner you care. Your entire statement will be made part of the record.

OFFICE OF THE SECRETARY

Mr. BISHOP. I am glad to be here to present the fiscal year 1986 budget request for the salaries and expenses appropriation, which provides funding for the Treasury Department's Office of the Secretary.

As you mentioned, accompanying me today are Carole J. Dineen, Fiscal Assistant Secretary for the Bureau of Public Debt and the Financial Management Service; Katherine D. Ortega, the Treasurer of the United States, who will summarize the requests of the U.S. Mint and Savings Bonds Division.

In addition, we have at the table Mrs. Donna Pope, Director of the U.S. Mint.

PREPARED STATEMENTS

With your permission, I would like to submit the statements of the five bureaus here today, and I would like to summarize the statement of the Office of the Secretary.

Senator ABDNOR. Without objection, the entire statements will be made part of the record.

[The statements follow:]

STATEMENT OF JOSEPH E. BISHOP

Mr. Chairman and Members of the Committee, it is a pleasure to be here today to discuss the FY 1986 budget request for the Salaries and Expenses appropriation, which provides funding for the Treasury Department's Office of the Secretary.

The Office of the Secretary has the important mission of providing support to the Secretary in his roles as chief financial officer of the Government, major policy advisor to the President and executive director of the Treasury Department.

The missions and functions of the Office of the Secretary are broad and diverse and include:

(1) Recommending and implementing U.S. domestic and international economic, monetary and tax policies;

(2) Managing the fiscal operations of the U.S. Government and the public debt;

(3) Overseeing Treasury's major law enforcement responsibilities;

(4) Undertaking international economic and financial responsibilities, as well as serving as the United States' representative to various international financial organizations;

(5) Serving as liaison with the Congress and the American public; and

(6) Providing administrative and management oversight of the Department's twelve bureaus, including the development of automated information processes;

Recent accomplishments illustrating the importance of these responsibilities are:

- Development of a proposal for simplification of the U.S. tax code;
- Negotiations on the Mexican, Brazilian and other international debt financing problems;
- Implementation of the Deficit Reduction Act of 1984 (Tax Reform Act); and

- Negotiations with the Japanese on the valuation of the yen.

The FY 1986 budget request for the Office of the Secretary reflects our commitment to provide resources necessary to fulfill the Office of the Secretary's important responsibilities, while at the same time restraining Federal spending and reducing staffing levels.

The Office of the Secretary's FY 1986 budget request totals $76.7 million, 1,245 permanent positions and 1,188 average positions. Of this amount, $22.4 million will support the broad economic policy direction activities within the Office of the Secretary. These include development of tax initiatives, economic forecasts, and fiscal policy, including management of the public debt and management of the production of coins, currency and postage.

An estimated $4.4 million will support the Inspector General function for the Department's non-law enforcement bureaus.

Approximately $13.0 million will support international activities, such as international monetary affairs, development financing, and trade and investment policy.

An estimated $27.9 million is for Departmental policy and administrative functions, such as budget, accounting, personnel, and procurement. I should point out that, among the major Departments, this is among the smallest level of resources for such functions.

Approximately $8.3 million will be used to maintain, operate and improve the Main Treasury and Annex buildings. As you know, the Office of the Secretary is unique because we own and operate our own buildings--Main Treasury and the Annex. Unlike most Federal agencies, the Office of the Secretary must budget funds specifically for the general operations of its buildings. These are funds that otherwise would have been paid to the General Services Administration.

General support operations include maintenance and repairs and utility services. Our FY 1986 request includes $0.7 million for Repairs and Improvements.

As I stated previously, in FY 1986 we are requesting $76.7 million, 1,245 permanent positions, and 1,188 average positions. This is a net reduction of $2.2 million and 37 permanent and average positions below the proposed FY 1985 level. This request is consistent with the Administration's objectives of reducing the cost of governmental operations and federal civilian employment levels.

Specifically, our FY 1986 request includes no programmatic increases. The only additional resources requested are $1.1 million in inflationary increases for the annualization of the FY 1985 pay raise.

In addition, the FY 1986 request includes reductions of $3.4 million to reduce Federal government spending through lower employment levels and employee salaries ($2.0 million), and through decreasing administrative overhead expenses ($1.4 million).

The decrease of $2.0 million in personnel compensation and related benefits reflects the Administration's proposal for a five percent reduction in Federal government employees' salaries and benefits as a way to reduce Federal spending. This reduction will be offset by a corresponding reduction in employees' salaries.

The decrease of $1.4 million and 37 permanent and average positions is the Office of the Secretary's share of a government-wide program to reduce administrative services by ten percent. Administrative overhead costs in such areas as equal employment programs and administrative services such as personnel, payroll, financial management, travel, printing, telecommunications, facilities management and other related services will be scaled back. These reductions will be achieved through on-going efforts to streamline our administrative operations, decentralize certain Departmental administrative and oversight functions, and continue

to achieve productivity savings through enhanced office automation and ADP efforts.

In conclusion, the FY 1986 request for the Office of the Secretary is an austere budget, consistent with the Administration's objectives to reduce the Federal budget deficit by reducing government spending. However, I believe it is also a realistic resource request which will enable the Office of the Secretary to perform all of its important responsibilities in support of the Secretary and the President.

Thank you for your consideration of our FY 1986 budget request and for your ongoing support of our ADP and building renovation efforts, which will be continued within the resources requested. I will be happy to answer any questions you may have at this time.

STATEMENT OF CAROLE J. DINEEN

Thank you, Mr. Chairman, I appreciate the opportunity to discuss the Fiscal Year 1986 resource requirements of the Financial Management Service and the Bureau of Public Debt. I will first cover the Financial Management Service.

FINANCIAL MANAGEMENT SERVICE

Last year, Secretary Regan approved changing the name of the Bureau of Government Financial Operations to the Financial Management Service, and this was intended to reflect the greater emphasis and recognition that is being placed on Federal financial management.

In recent years, the Service has undertaken an ambitious modernization effort to ensure that payments are made in the most effective and cost-efficient manner, that collections are optimized, that government funds are managed prudently, and that the governmentwide accounting function is carried out in a timely and accurate manner. In Fiscal Year 1986, we are continuing to build and expand upon our earlier developmental efforts. When fully

implemented, these modernization efforts will generate interest savings of over $1.0 billion annually, a return on investment which is very high. Because of these savings, the Treasury Department identifies the Financial Management Service as a profit center rather than a cost center.

The FY 1986 resources will provide necessary computer support for the redesigned check payment and reconciliation system and many of our other systems; will provide enhanced security for computer and funds transfer systems, as well as our financial centers, and will continue the cash management improvement programs. In order to accomplish these goals we have identified the FY 1986 resource requirements as $248,121,000 and 2,300 average positions.

ADMINISTERING THE PUBLIC DEBT

I now turn to the Bureau of Public Debt. For administering the public debt of the United States we are requesting an appropriation of $197,225,000 in FY 1986. This Bureau's request reflects significant savings resulting from several improvements in management systems. The savings are indicative of the Bureau's commitment to improving its operations through automating securities handling processes and enhancing internal controls. This year's request reflects major savings resulting from instituting full book-entry for marketable securities. The move to full book-entry is significant because it provides improved service and reduced risk of lost securities to investors as well as cost savings to the Bureau. Net cumulative savings in excess of $67 million will be realized over seven years as the new system is phased in.

Improvements continue to be made in the saving bonds program, also. For example, our FY 1986 budget requests funding to purchase high speed data capture equipment to process savings bond issues. Significant savings are projected in FY 1987 due to the application of the improved technology. Funding for a new computer is also requested which will improve both the savings bond and marketable programs in years to come.

That concludes my prepared statement on the Fiscal Service appropriations. Mr. Chairman, I will be glad to respond to any questions that you and members of the subcommittee may have.

STATEMENT OF KATHERINE D. ORTEGA

Mr. Chairman and members of the Committee, I am pleased to appear before you today to testify on the United States Mint's and U.S. Savings Bonds Division's FY 1986 budget request. I am accompanied by Donna Pope, Director of the U.S. Mint and Steve Mead, Executive Director, U.S. Savings Bonds Division.

U.S. MINT

This year's salaries and expenses appropriation request for the U.S. Mint is for $46,954 million and 990 average positions which is a decrease of $804 thousand and 30 average positions from the FY 1985 continuing resolution.

The Mint is planning production of 16.2 billion domestic coins. This domestic coin production combined with an inventory reduction will meet the Federal Reserve's needs.

There are several initiatives included in this request which begin a multi-year improvement plan for the Mint. Specifically, there are funds for a Research and Development Program, space planning at the Philadelphia Mint, and coin production equipment investments.

I am pleased to report on the success of the Olympic Coin Program. As of January 31, 1985, over $69.8 million has been provided to the U.S. Olympic Committee and the Los Angeles Olympic Organizing Committee, for support of our Olympic efforts. Exceeding our goal of raising $65 million is a significant achievement for all involved with the Program.

Several new commemorative and bullion coin programs have been introduced in this session including legislation to produce a Statue of Liberty-Ellis Island Commemorative Coin.

SAVINGS BONDS DIVISION

The mission of the U.S. Savings Bonds Division is to reduce Federal spending by promoting the sale and retention of U.S. Savings Bonds.

Savings Bonds are particularly important now because they are the most cost effective way the Treasury has to finance the public debt. We estimate that bonds are 2 to 2-1/2 percentage points less costly than marketable debt of the same maturity. This translates into interest costs savings of nearly $2 billion in FY 1984 based on the $73.7 billion in bonds outstanding, and we expect even greater savings in FY 1985.

In addition to helping the United States Government finance its debts in the least expensive way possible, the program provides an opportunity for millions of American savers to participate in the financing of their Government and to develop habits of individual thrift which contribute to our broader economic objectives of increasing savings and reducing inflation.

For Fiscal Year 1986, the Division is requesting $17.4 million and 273 FTE positions. This request is a net decrease of $327,000 and 3 FTE positions from the authorized level for Fiscal Year 1985.

In order to operate most effectively with reduced funding, the Division will continue to rely heavily on unpaid volunteers from banking, business, and industry. Volunteers who know Savings Bonds appreciate their benefits and welcome the challenge of leadership in a worthy cause. Outstanding leaders from many fields of endeavor make up the working committees whose services are utilized at the national, state, and local levels.

During Fiscal Year 1986, the Division will continue to concentrate its efforts on achieving the greatest possible sales growth and building its key markets, especially payroll savings. Efforts will be concentrated on those accounts which offer the greatest sales potential in order to make the most cost effective use of existing staff and volunteer resources.

Mr. Chairman, this concludes my prepared remarks. We will be glad to answer any questions you may have.

STATEMENT OF DONNA POPE

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I AM PLEASED TO PRESENT FOR YOUR CONSIDERATION THE FISCAL YEAR 1986 APPROPRIATION REQUEST FOR OPERATIONS OF THE UNITED STATES MINT.

THE MINT'S FY1986 BUDGET REQUEST FOR SALARIES AND EXPENSES IS $46,954 MILLION AND 990 AVERAGE POSITIONS. THE FY1986 APPROPRIATED REQUEST REFLECTS A DECREASE OF $804 THOUSAND AND 30 AVERAGE POSITIONS FROM THE TOTAL OF $47.758 MILLION AUTHORIZED UNDER THE CURRENT FY1985 CONTINUING RESOLUTION.

THIS BUDGET REQUEST WILL ALLOW THE MINT TO PRODUCE 16.2 BILLION COINS. COMBINED WITH A 2.2 BILLION COIN INVENTORY DRAWDOWN, THIS PRODUCTION WILL SATISFY PROJECTED REQUIREMENTS OF 18.4 BILLION COINS AND STILL MAINTAIN INVENTORIES AT LEVELS NECESSARY TO INSURE AN ADEQUATE COIN SUPPLY FOR THE NATION'S ECONOMY. REVENUES RESULTING FROM FISCAL YEAR 1986 OPERATIONS OF THE UNITED STATES MINT ARE ESTIMATED TO BE APPROXIMATELY $485 MILLION; THIS CONSISTS OF SEIGNIORAGE OF $471 MILLION AND $14 MILLION FROM THE SALE OF NUMISMATIC ITEMS.

THE BUDGET DECREASE IS COMPOSED OF THE FOLLOWING MAJOR CHANGES:

- o DECREASES OF $5,330 MILLION AND 30 AVERAGE POSITIONS RESULT PRIMARILY FROM CHANGES IN COIN PRODUCTION, THE ADMINISTRATION'S PROPOSED LEGISLATION TO REDUCE FEDERAL SALARY RATES BY 5%, THE ADMINISTRATION'S GOAL OF REDUCING ADMINISTRATIVE AND OTHER OVERHEAD COSTS BY 10% AND PRODUCTIVITY IMPROVEMENTS.
- o INCREASES OF $2,124 MILLION FOR RESEARCH AND DEVELOPMENT, FOR ARCHITECTURAL AND ENGINEERING PLANS FOR THE PHILADELPHIA MINT, FOR PURCHASE OF NEW COINING PRESSES AND FOR PURCHASE OF SOUND ENCLOSURES FOR PHILADELPHIA.
- o INCREASES OF $2,402 MILLION TO OFFSET INFLATION.

THE MOST IMPORTANT ELEMENT OF THIS YEAR'S REQUEST IS THE INITIATION OF A MULTI-YEAR PLAN TO POSITION THE MINT TO EFFICIENTLY MEET FUTURE COIN PRODUCTION REQUIREMENTS.

RESEARCH AND DEVELOPMENT

FOR THE FIRST TIME IN RECENT YEARS, THE MINT IS SPECIFICALLY PROPOSING RESEARCH AND DEVELOPMENT (R&D) FUNDS TO EXPLORE THE APPLICATION OF TECHNOLOGICAL IMPROVEMENTS TO BOTH THE DOMESTIC COINING PROCESS AND REIMBURSABLE OPERATIONS. IN FY1986, WE ARE ASKING FOR A TOTAL OF $1,050,000 IN APPROPRIATED FUNDING AND $295,000 IN REIMBURSABLE FUNDING FOR THIS. WE HAVE ALREADY BEGUN SOME HIGH PRIORITY PROJECTS. EACH OF THESE R&D PROJECTS HAS THE POTENTIAL FOR SIGNIFICANT CONTRIBUTION TO INCREASED PRODUCTIVITY AND/OR REDUCED COST.

PHILADELPHIA ARCHITECTURAL AND ENGINEERING (A&E) PLAN

IN FY1985, THE MINT WILL COMPLETE CONCEPTUAL PLANS TO UTILIZE THE SPACE MADE AVAILABLE IN THE PHILADELPHIA MINT AS A RESULT OF DISCONTINUING IN-HOUSE PRODUCTION OF COINAGE STRIP.

IN FY1986, IT IS ESTIMATED THAT $550 THOUSAND, HALF IN APPROPRIATED FUNDS AND HALF IN REIMBURSABLE FUNDS, WILL BE REQUIRED TO CONTRACT FOR A&E PLANS FOR OPTIMAL UTILIZATION OF THIS SPACE.

EQUIPMENT

THIS ACTIVITY INCLUDES FUNDS FOR THE REPLACEMENT OF WORN OUT AND OBSOLETE EQUIPMENT. IN ADDITION, FUNDS ARE REQUESTED FOR SEVEN (7) NEW COIN PRESSES TO BE PLACED IN THE EXPANDED DENVER FACILITY AND SOUND ENCLOSURES FOR COINING PRESSES AT THE PHILADELPHIA MINT.

COIN PRODUCTION

THE MINT HAS FIVE (5) FIELD OFFICES OF WHICH FOUR (4) ARE ENGAGED IN THE COIN MANUFACTURING PROCESS. THEY ARE: THE PHILADELPHIA AND DENVER MINTS, THE SAN FRANCISCO ASSAY OFFICE AND THE WEST POINT BULLION DEPOSITORY.

IN FISCAL YEAR 1984, WE PRODUCED 17.9 BILLION COINS. A PRODUCTION OF 16.9 BILLION COINS FOR FY1985 WILL BE SUFFICIENT TO MEET THE FEDERAL RESERVE BANKS' REQUIREMENT.

THE FY1986 BUDGET REQUEST WILL ALLOW THE MINT TO PRODUCE 16.2 BILLION COINS. COMBINED WITH A 2.2 BILLION COIN INVENTORY DRAWDOWN, THIS PRODUCTION WILL SATISFY THE FEDERAL RESERVE BANKS' PROJECTED REQUIREMENTS OF 18.4 BILLION COINS AND STILL MAINTAIN INVENTORIES AT LEVELS NECESSARY TO INSURE ADEQUATE COIN SUPPLY FOR THE NATION'S ECONOMY.

COINAGE STRIP SOURCES

We have been trying for several years to expand our sources of supply of coinage strip. Recently we have obtained additional competition for our supply of cupro-nickel strip. Bridgeport Brass received the most recent competitively bid contract for cupro-nickel supplies to both the Philadelphia and Denver Mints. We are also exploring the potential for buying blanks for 5-50¢ coins rather than strip materials.

DENVER EXPANSION AND IMPROVEMENTS

In May 1984, a construction contract in the amount of $10,143,000 was awarded to Caddell Construction Company to complete the planned improvements at the Denver Mint. Building construction is expected to be completed early in 1986. No additional building construction funds are requested for FY1986. When the seven new coin presses I mentioned earlier are installed in 1987, Denver will be able to produce at a capacity of 9 billion coins per year.

PERSONNEL

Our employment level for FY1986 will be 1,765 workyears, 990 from appropriated funds and 775 from reimbursable activities. This is 30 fewer appropriated workyears and 73 fewer reimbursable years than was authorized in FY1985. This reduction results from slightly lower coin production, increased productivity and greater efficiencies in administration.

CONTINUING AUDITS OF GOLD

A program for continuing audits of United States owned-gold began in 1974 with the purpose of providing a complete audit of United States owned-gold. The audit of Mint held gold was virtually completed during fiscal year 1984.

As of September 30, 1984, over 94 percent of United States owned-gold bullion at Mint depositories has been audited and all 94 percent found to agree with the records. This represented 235 million of the 249.3 million fine troy ounces of gold bullion held by Mint facilities as of September 30, 1984.

Also, as of September 30, 1984, the total amount of United States owned-gold was 262.8 million fine troy ounces of which 13.5 million was held by the Federal Reserve Bank of New York.

Due to the continued need for an independent audit of United States owned-gold, a new gold audit program was initiated in fiscal year 1983. The

COMMITTEE GOVERNING THE GOLD AUDIT PROGRAM IS REPRESENTED BY THE OFFICE OF THE INSPECTOR GENERAL AND THE FEDERAL RESERVE BANK OF NEW YORK. ANNUALLY THE COMMITTEE WILL PREPARE A REPORT ON THE STATUS OF THE AUDIT OF UNITED STATES OWNED-GOLD, TO THE INSPECTOR GENERAL, DEPARTMENT OF THE TREASURY, WHO WILL REPORT THE FINDINGS TO THE SECRETARY OF THE TREASURY. AUDITS WERE CONDUCTED UNDER THIS NEW PROGRAM AT THE FORT KNOX BULLION DEPOSITORY AND AT THE DENVER MINT DURING 1983 AND 1984. GOLD REAUDITED UNDER THE NEW PROGRAM TOTALLED 34.2 MILLION FINE TROY OUNCES.

EQUAL EMPLOYMENT OPPORTUNITY

POSITIVE GAINS HAVE BEEN ACCOMPLISHED THROUGH THE IMPLEMENTATION AND ADOPTION OF THE GOALS AND TIMETABLES ESTABLISHED IN OUR AFFIRMATIVE ACTION PROGRAM. THE EMPLOYMENT STATISTICS ON MINORITIES AND WOMEN HAVE INCREASED GRADUALLY RESULTING FROM CONCERTED RECRUITING EFFORTS AND UTILIZATION OF SPECIAL EMPHASIS PROGRAMS THAT EMPHASIZES THE HIRING OF HANDICAPPED, VETERANS, WOMEN AND PART-TIMERS. THESE INCREASES ARE REFLECTED IN OUR CURRENT MINT-WIDE EMPLOYMENT STATISTICS WHICH SHOW THAT MINORITIES (MALE AND FEMALE) COMPRISE 54.13% OF OUR TOTAL EMPLOYMENT.

ADP

THE UNITED STATES MINT'S FUTURE SUCCESS DEPENDS, IN PART, UPON THE EFFECTIVE AND EFFICIENT USE OF ITS INFORMATION SYSTEMS RESOURCES TO SUPPORT THE PLANNING, OPERATION AND CONTROL OF MINT ACTIVITIES. A FIVE YEAR PLAN HAS BEEN COMPLETED AND INCORPORATES A NEW APPROACH TO MEETING INFOPMATION NEEDS OF THE MINT. THE PLAN CALLS FOR THE USE OF A DISTRIBUTED INFORMATION SYSTEMS CONFIGURATION USING MINICOMPUTERS AT EACH MAJOR MINT FACILITY. THIS WILL REPLACE THE CURRENT CENTRALIZED-SYSTEM, A SYSTEM WHICH IS APPROXIMATELY TEN YEARS OLD AND OUTDATED. TO ACQUIRE THE DESIRED DATA PROCESSING CAPABILITIES, WE AWARDED A CONTRACT TO SYSOREX CORPORATION ON SEPTEMBER 26, 1984. WE HAVE NOW BEGUN INSTALLING MODERN HARDWARE AND SOFTWARE.

REIMBURSABLE OPERATIONS

THE MINT'S NUMISMATIC AND MEDAL PROGRAMS FOR FY1986 WILL PRIMARILY CONSIST OF: ANNUAL PROOF COIN SETS; ANNUAL UNCIRCULATED COIN SETS AND CONGRESSIONALLY AUTHORIZED MEDALS. ALL PRODUCTION OPERATIONS AND SALES ACTIVITIES RELATED TO THESE PROGRAMS ARE FINANCED FROM REIMBURSABLE FUNDS. THE MINT EXPECTS TO PRODUCE AND SELL 4 MILLION PROOF COIN SETS AND 3 MILLION

UNCIRCULATED SETS DURING FY1986. IN FY1986, IT IS EXPECTED THAT $14 MILLION WILL BE EARNED FOR THE GENERAL FUND FROM THESE PROGRAMS.

ON JANUARY 3, 1985, CONGRESSMAN ANNUNZIO INTRODUCED LEGISLATION DIRECTING THE MINTING OF COMMEMORATIVE GOLD, SILVER AND CUPRO-NICKLE COINS TO RAISE FUNDS FOR RESTORATION OF THE STATUS OF LIBERTY AND ELLIS ISLAND. THIS WOULD BE A MAJOR UNDERTAKING, PERHAPS ON THE SCALE OF THE OLYMPIC COIN EFFORT.

BASED UPON THE LAST SESSION OF CONGRESS, MANY OTHER BILLS CALLING FOR GOLD AND SILVER COINS ARE EXPECTED TO BE INTRODUCED THIS YEAR. ANY ONE OF THESE PROPOSED EFFORTS WOULD REQUIRE REIMBURSABLE RESOURCES, BOTH FUNDS AND FULL TIME EQUIVALENT EMPLOYMENT, THAT ARE NOT INCLUDED IN THIS REQUEST.

OLYMPIC COMMEMORATIVE COINS

PUBLIC LAW 97-220, DATED JULY 22, 1982, PROVIDED FOR STRIKING OF UP TO 50 MILLION ONE DOLLAR SILVER COINS DATED 1983 AND 1984 AND UP TO 2 MILLION TEN DOLLAR GOLD COINS DATED 1984 TO ASSIST THE UNITED STATES OLYMPIC EFFORT AND THE 1984 OLYMPIC GAMES IN LOS ANGELES.

SALES OF OLYMPIC COINS ENDED JANUARY 18, 1985 AND MELT DOWN PROCEDURES OF THOSE OLYMPIC COINS REMAINING IN MINT INVENTORY BEGAN AT THE END OF JANUARY. A MAJOR MARKETING PROGRAM WAS CONDUCTED FOR THE DOMESTIC SALE OF OLYMPIC COINS INCLUDING: COIN CONSIGNMENT TO FINANCIAL INSTITUTIONS, TELEMARKETING AND TELEVISION ADVERTISING. INTERNATIONAL PROMOTION AND SALE OF THE OLYMPIC COINS WERE EXECUTED BY MAISON LAZARD AN INTERNATIONAL BULK DISTRIBUTOR.

AS OF FEBRUARY 1985, A TOTAL OF 4.3 MILLION SILVER OLYMPIC COINS AND 537 THOUSAND OLYMPIC GOLD COINS WERE SOLD WITH OVER $69.8 MILLION IN SURCHARGES TURNED OVER TO THE OLYMPIC COMMITTEES. ALL COSTS WERE FULLY RECOVERED FROM SALES PROCEEDS AND THERE WAS A SMALL OPERATING PROFIT.

GOLD MEDALLIONS

PUBLIC LAW 95-630, APPROVED NOVEMBER 10, 1978, PROVIDED FOR THE STRIKING AND SALE OF ONE OUNCE AND HALF OUNCE GOLD MEDALLIONS OVER A FIVE YEAR PERIOD. THE 1984 MEDALLIONS AS WELL AS THE PREVIOUS YEAR'S ISSUES WERE SOLD THROUGH A TELEPHONE ORDERING SYSTEM OPERATED BY MINT STAFF. SALES BEGAN IN OCTOBER OF 1984 AND WILL END MARCH 1, 1985. OVER 70,000 OUNCES OF GOLD WERE SOLD WITH SALES IN EXCESS OF $24 MILLION.

ANNUAL PROOF COIN SETS

THE FIVE COIN PROOF SET WHICH IS PRODUCED EACH YEAR CONTAINS ONE OF EACH COIN PRODUCED BY THE MINT (CENT THROUGH THE HALF DOLLAR) AND IS PRODUCED AT THE SAN FRANCISCO ASSAY OFFICE ONLY. ALL OF THE COINS HAVE THE "S" MINT MARK AND ARE OF THE HIGHEST QUALITY, WITH SPECIAL ATTENTION GIVEN TO ALL ASPECTS OF COIN PRODUCTION AND HANDLING. THESE SETS ARE SOLD THROUGH THE MINT'S MAILING LIST AND OVER-THE-COUNTER AT THE MINT'S FOUR SALES AREAS AS WELL AS AT NUMISMATIC AND FINANCIAL CONVENTIONS THROUGHOUT THE YEAR. PLANS ARE PRESENTLY BEING DEVELOPED TO MAKE THESE SETS AVAILABLE, THROUGH A CONSIGNMENT PROGRAM, FOR DIRECT SALE BY FINANCIAL INSTITUTIONS THROUGHOUT THE COUNTRY. WE ANTICIPATE HAVING THIS PROGRAM IN PLACE FOR THE 1985 PROOF SETS.

UNCIRCULATED COIN SETS

UNCIRCULATED COIN SETS CONTAIN ONE OF EACH CIRCULATION-QUALITY COIN STRUCK BY BOTH THE PHILADELPHIA AND DENVER MINTS. THIS PROGRAM WAS RESUMED LAST YEAR WITH SALES OF 1984 SETS TOTALLING 1.8 MILLION SETS TO DATE. UNLIKE COINS IN A PROOF SET, UNCIRCULATED COINS ARE NOT STRUCK ON SPECIAL BLANKS NOR MADE BY A SPECIAL PROCESS.

NATIONAL MEDALS

THESE MEDALS, GENERALLY IN GOLD, ARE SELECTIVE AWARDS AUTHORIZED BY ACTS OF CONGRESS IN COMMEMORATION OF NOTEWORTHY SEGMENTS OF AMERICAN HISTORY, OR FOR OUTSTANDING PERSONAL SERVICES TO AMERICA. THEY ARE PRODUCED BY THE U. S. MINT. THE LEGISLATION PROVIDING FOR THE PRODUCTION OF THESE MEDALS USUALLY ALSO PROVIDES FOR BRONZE DUPLICATES TO BE PRODUCED AND SOLD BY THE U. S. MINT.

SUMMARY

THE MINT IS REQUESTING AN APPROPRIATED BUDGET OF $46.954 MILLION THAT WILL PROVIDE FOR: (1) EXPECTED COIN DEMAND IN FY1986; (2) INVESTMENT IN EQUIPMENT TO EXPAND REQUIRED COINAGE CAPABILITY IN THE NEAR FUTURE; (3) RESEARCH AND DEVELOPMENT TO IMPROVE COINING PROCESSES AND (4) PLANNING OPTIMAL USE OF PRODUCTION SPACE.

THIS CONCLUDES MY PREPARED REMARKS. I WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

STATEMENT OF KATHERINE D. ORTEGA

Mr. Chairman and members of the Committee, I appreciate this opportunity to present the 1986 appropriation request of the United States Savings Bonds Division.

The mission of the U. S. Savings Bonds Division is to reduce federal spending by promoting the sale and retention of U. S. Savings Bonds.

Savings Bonds are particularly important now because they are the most cost effective way the Treasury has to finance the public debt. We estimate that bonds are 2 to 2 1/2 percentage points less costly than marketable debt of the same maturity. This translates into interest cost savings of nearly $2 billion in FY 1984 based on the $73.7 billion in bonds outstanding, and we expect even greater savings in FY 1985.

In addition to helping the United States Government finance its debts in the least expensive way possible, the program provides an opportunity for millions of small savers to participate in the financing of their government and to develop habits of individual thrift which contribute to our broader economic objectives of increasing savings and reducing inflation.

During fiscal 1984, public acceptance of the Bond Program increased, because of the hundreds of positive editorial messages and thousands of advertisements produced by the media. The leadership of volunteers coupled with leadership from the Division produced an active, exciting 1984 campaign year.

Through a survey undertaken by the Gallup organization, we have learned much more about our markets. Specifically, we have learned how more accurate information and an improved sales positioning can increase our penetration of the marketplace. We have been shown where our efforts can be concentrated in order to increase sales in the years to come.

To follow up on the Gallup survey, and to conduct on-going research on all areas of Division activity, we have established a

planning and research staff. This will strengthen our long-range planning efforts and help us manage our new information systems.

The Division also has taken steps to enter one of the fastest growing areas in employee benefits--deferred compensation plans. As a result of a regulatory change requested by the Division and adopted late last year, Savings Bonds are now eligible for inclusion in such plans. Our staff has conducted an intensive and successful employer notification program.

The net results of all these efforts has been a significant strengthening of the Bond Program's cost-effectiveness. As of September 30, 1984 sales of Series EE and HH Bonds amounted to $3.9 billion; redemptions remained at $6.0 billion and the amount outstanding reached $73.7 billion, which is an increase of $3.1 billion over the end of FY 1983.

For fiscal year 1986, the Division is requesting $17.4 million and 273 FTE positions. This request is a net decrease of $327,000 and 3 FTE positions from the authorized level for fiscal year 1985.

In order to operate most effectively with reduced funding, the Division will continue to rely heavily on unpaid volunteers from government, business, and industry. Volunteers who know Savings Bonds appreciate their benefits and welcome the challenge of leadership in a worthy cause. Outstanding leaders from many fields of endeavor make up the working committees whose services are utilized at the national, state, and local levels.

During fiscal 1986, the Division will continue to concentrate its efforts on achieving the greatest possible sales growth and building its key markets, especially payroll savings. Efforts will be concentrated on those accounts which offer the greatest sales potential in order to make the most cost effective use of existing staff and volunteer resources.

We will continue to place special emphasis on achieving greater public awareness of the features and benefits of Savings Bonds. Advertising will increasingly stress the long-term value of bonds in addition to the immediate convenience of automatic savings.

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Also, over-the-counter sales through banks and other financial institutions will be strongly promoted.

Mr. Chairman and members of the Committee, this concludes my statement. We will be happy to answer any questions that you or members of your committee may have.

Statement of W.M. Gregg

INTRODUCTION

Mr. Chairman and Members of the Committee, I appreciate this opportunity to discuss with you our FY 1986 appropriation request for "Administering the Public Debt." The appropriation provides funds for both the Bureau of the Public Debt and the U.S. Savings Bonds Division. The latter is a separate organization responsible for promoting the sale of savings bonds and its requirements will be discussed separately.

The Bureau of the Public Debt is a service organization responsible for the administrative functions required to conduct Treasury's debt financing activities and accounting for the public debt. The Bureau maintains a field office in Parkersburg, West Virginia, as well as the headquarters office in Washington, D.C.

FY 1986 APPROPRIATION REQUEST

We are requesting an appropriation of $197,225,000 for the Bureau of the Public Debt and the U.S. Savings Bonds Division in FY 1986. This is $1,527,000 less than the amount available for FY 1985. The FY 1985 proposed authorized level includes a rescission of $52,000 and a pay supplemental of $849,000. Program increases and increases necessary to maintain current levels in FY 1986 total $9,995,000. These increases, however, are offset by reductions of $11,522,000 resulting from productivity savings and management improvements, program reductions, nonrecurring costs, and administration initiatives to reduce government spending. The savings achieved in FY 1986 include a 5% pay cut and an administrative staffing reduction of 24 FTE work-years. Program increases, and other dollar and FTE savings reflected in the Bureau's FY 1986 budget, result from the Bureau's continuing efforts to move towards an increasingly automated operational environment. I would now like to briefly

highlight for you the major initiatives presented in the FY 1986 budget for the Bureau of the Public Debt.

MARKETABLE PROGRAM

During our FY 1984 and FY 1985 Congressional hearings, I advised the Committee of the Bureau's plans for improving the marketable securities program. The largest initiative the Bureau is currently undertaking is the establishment of a full book-entry system for marketable securities accounts maintained by Treasury. This system is being developed jointly by the Bureau and the Federal Reserve and will replace our current registered securities and Treasury bill systems. The new system will enable the Bureau to provide maximum reinvestment opportunities as well as prompt direct service to account holders who will receive payment via an automated payment system.

Since I last discussed the development of the Treasury Direct-Access Book-Entry System (T-DAB) with you, the user requirements and the general design of the system have been completed. As a result of completing those phases of the project, we have somewhat expanded the scope and size of the T-DAB system; savings are projected to be larger; and the implementation date has been revised. The increased scope of the T-DAB system results from a better understanding of the Bureau's requirements, the addition of a front-end original issue processing function, and an expanded payment capability. Because of the larger volumes expected to be processed on the T-DAB system and the system's expanded capabilities, we now expect to implement T-DAB in mid-1986. The savings to be achieved through this initiative over a seven-year period from the date of implementation have also been revised from $43 million to $67 million and a reduction of approximately 380 work-years.

I would also like to take this opportunity to advise the Committee that commercial book-entry services for marketable securities have recently been validated as a fiscal agent function performed by the Federal Reserve Banks for the Treasury and for which the Bureau has overall responsibility. The Bureau, rather than the Banks, will set fees to be collected for the service, and, to the extent funds are available, the Bureau will reimburse the Federal Reserve Banks for the cost of performing these commercial book-entry services.

Reimbursing the Federal Reserve for the cost of book-entry account maintenance and securities transfer services will reinforce the Treasury's primary responsibility for these activities, will ensure that the commercial book-entry system receives an appropriate priority within the Federal Reserve System, and will make the full cost of administering the public debt available to the Bureau for review.

SAVINGS BOND PROGRAM

Over the last couple of years I have discussed with you the positive public response to the variable rate savings bond which was introduced in November 1982. In FY 1984, savings bonds sold increased from FY 1983 actual levels by 6.8 percent. We are projecting that savings bond sales will remain high in FY 1985 and FY 1986 because of the attractiveness of the interest rate calculation formula. We also expect that savings bond redemptions will remain constant because of the final maturity of bonds issued in the early 1940's and because redemptions increase as more bonds are sold. For FY 1985 and FY 1986, sales are estimated at 73 million pieces and redemptions at 75.2 million pieces.

The major initiative reflected in the FY 1986 budget submission for the Savings Bond program is the purchase of Optical Character Recognition/Magnetic Ink Character Recognition equipment (OCR/MICR). We have recently purchased OCR/MICR equipment to process retired savings bonds and are requesting funds in FY 1986 to purchase OCR/MICR equipment to process savings bond issues. The OCR/MICR equipment is a high speed data capture and recording system which will be cost beneficial and will eliminate the need for approximately 17 work-years in FY 1987. Additionally, the equipment will allow the Bureau to move from an outdated punch card bond to a paper bond.

TECHNOLOGICAL IMPROVEMENTS

The Bureau is also requesting $1,682,000 in this budget to replace its mainframe computer. The funds requested in FY 1986 are for the first phase of a five-year project to replace the computer with a new central processor, terminals, and support equipment. The current system, installed in early 1976, uses outdated memory and processor technologies which are not flexible enough to meet the Bureau's future needs. Further major expansion of the current system would be both impractical and

costly as the current operating system will not be supported by the vendor after January 1986. The new computer equipment will thus enable the Bureau to improve its operational systems as well as ensuring the protection of resources in our automated systems. The new equipment will also produce a net cumulative savings, over its six-year life cycle, of approximately $4.4 million.

Last year I requested FY 1985 funding so that the initial stage of our computer replacement program could begin in late 1985. However, it took longer than anticipated to define our management objectives in this important undertaking, and it will not be feasible to award a contract until FY 1986. I am, therefore, requesting the required funding in FY 1986.

CONCLUSION

Mr. Chairman, this concludes my prepared remarks. We will be glad to answer any questions that you and the members of your committee may have.

STATEMENT OF WILLIAM E. DOUGLAS

Mr. Chairman and members of the Committee, I am pleased to be here this afternoon to present to you the Fiscal Year 1986 resource requirements of the Financial Management Service.

Last summer, the Secretary of the Treasury approved the renaming of the Bureau of Government Financial Operations to the Financial Management Service. The new name clearly reflects the greater emphasis and recognition that is being placed on financial management in the Federal Government.

The mission of the Financial Management Service is "to promote the financial integrity of the United States Government through sound money management on behalf of the public". Our objective is to assure that the systems by which the Federal Government's money and financial information are moved and managed are timely, accurate and properly controlled, whether we are providing services or regulating the provision of those services. These financial systems touch the lives of all Americans, from income tax recipients to Railroad Retirement annuitants to Social Security beneficiaries. Also, financial information that will be generated will affect all Americans but specifically will aid the Congress (through the Congressional Budget Office and the General Accounting Office) and the Executive agencies (primarily the Treasury and the Office of Management and Budget) to deal more effectively with the national financial issues before us.

In recent years, the Service began an ambitious modernization effort and in Fiscal Year 1986 we are continuing to build and expand upon earlier developmental efforts. We are doing so because the services that we provide to the American people are vital and the return on investment to taxpayers is high. When fully implemented, the modernization efforts which are now underway are expected to generate major improvements in productivity, quality and timeliness of service, as well as interest savings of over one billion dollars annually. Thus the Financial Management Service is a profit center rather than a cost center.

For Fiscal Year 1986, the Service is requesting $248,121,000 and 2,300 average positions. This request represents a reduction of 27 average positions and an increase of $5.3 million over FY 1985. This

request will allow us to continue our basic operations as well as major systems modernization efforts that, when complete, will generate significant interest savings to the Government. The Service's request is divided into four functional areas and an administrative function to be addressed in the following order: (1) Disbursement and Claims; (2) Governmentwide Accounting; (3) Banking and Cash Management; (4) General Financial Services; (5) Administration.

Disbursement and Claims

The Disbursement and Claims activity is requesting $152,544,000 and 1,378 average positions for FY 1986. The requested amount represents a decrease of $2.3 million and 14 positions from the FY 1985 level.

This activity processes payments and claims for most civilian government agencies and resolves claims regarding forged, lost, stolen and destroyed checks. Approximately 470 million Treasury checks are issued annually in the form of vendor payments, income tax refunds, and recurring benefit payments such as those of the Social Security and Veterans Administration.

A major change in check payments is now taking place. We are phasing out our punch card checks in favor of paper checks. In mid-February, the Philadelphia Financial Center started issuing the new checks to Internal Revenue Service Tax refund recipients in Delaware, the District of Columbia, Maryland and Pennsylvania. In May, 1985, approximately 200,000 Social Security recipients in Philadelphia will begin receiving their payments with the new checks. The full nationwide conversion will begin with the December, 1985 Social Security payments (about 20 million checks per month). In February, 1986, all Internal Revenue Service tax refunds will be made by paper check and throughout 1986 we will phase in other payments such as Supplemental Security Income, Civil Service Retirement and Railroad Retirement benefits.

Mr. Chairman, while we are very proud of our paper check conversion effort, an effort that will save the taxpayers $6 million per year, we still encourage our recurring government payment recipients, like Social Security beneficiaries, to convert their payments to the Direct Deposit/Electronic Funds Transfer (DD/EFT) method of receiving payments. The use and acceptance of DD/EFT is growing; in FY 1984, over 250 million EFT payments were issued

Governmentwide. In FY 1986, we project that 40% of all payments will be made electronically.

One of the Service's largest single expenditures occurs in the Disbursement and Claims area, that is the postage cost to mail the checks and bonds. Over thirty-three percent of our budget is directed toward this one expenditure. In February, the postage cost went up by $.02 per item. For us, this cost translates into a $6.6 million increase just for FY 1985. As a result, we have requested a $6.6 million FY 1985 supplemental appropriation. In order to hold down postage cost, we will continue to actively encourage the use of the DD/EFT method of payment, since this payment method costs a fraction of what it cost to process a traditional paper check.

Governmentwide Accounting

The Governmentwide Accounting activity is requesting $38,994,000 and 676 average positions for FY 1986. The major responsibilities of this activity include check reconciliation, management of the central Government accounting and reporting systems, disclosure of the fiscal assets and liabilities of the U.S. Treasury, integration of Treasury cash and funding operations with those of all Federal agencies, and the publication of financial reports.

One of the automated systems that supports these functions is the Check Payment and Reconciliation (CP&R) System. CP&R was designed and installed in the mid 1950's. The system processes 1.3 billion transactions a year and maintains a status file on 5.5 billion check records. This system is currently being redesigned to improve the productivity and effectiveness of our reconciliation and claims functions, while supporting the Service's goal of assuring competent delivery systems for both payments and collections.

Banking and Cash Management

The Banking and Cash Management activity is requesting $55,250,000 and 208 average positions for FY 1986. Through the Banking and Cash Management activity, the Service directs and oversees sound cash management, and the coordination of payments, collections, financial reporting, and investment activities to ensure that financial managers at Federal agencies make the most efficient use of their resources. Progressive cash management programs are substantially reducing the Government's borrowing cost. Since

interest rates on the national debt have become the third largest item in the federal budget, saving hundreds of millions of dollars annually, through improved cash management ranks high on the Government's list of priorities.

Reimbursement for the Federal Reserve Bank Operations represents more than 75 percent of Banking and Cash Management resources, and will require $41,461,000 in FY 1986. The Federal Reserve Banks and commercial depositories are reimbursed for such services as the maintenance of Federal Tax Deposit and Treasury Tax and Loan (TT&L) Accounts, Treasury General Accounts, and an account established for processing U. S./Iran Claims. The net interest earned by Treasury on deposits held in tax and loan accounts is estimated at over $500 million for FY 1986. This interest is in addition to the savings we will realize from our various improvement projects.

Since the federal government processes about $7 billion each business day, meeting cash management objectives depends on the most advanced techniques for electronically transferring funds and information. The Treasury Financial Communications System, the Service's automated link to the Federal Reserve System, offers several, nearly instantaneous ways of access to the nation's vast network of financial institutions for both payment and collection activities. The Service also uses the Automated Clearing House system for electronically transmitting payments, primarily recurring payments like Social Security benefits, Veterans benefits and Federal salaries. These programs are part of a unified approach to a cash management system which will return substantial interest savings year after year and move the Government toward more modern day commercial practices.

General Financial Services

The General Financial Services activity is requesting $1,333,000 and 38 average positions for FY 1986. This is the Service's smallest activity and it provides financial services for a number of accounts, including the two Social Security Trust Funds, the two Medicare Trust Funds, the Unemployment Trust Fund, the Presidential Election Campaign Fund, the Highway Trust Fund and a number of smaller accounts.

This activity is also responsible for processing Postal Savings Account claims. Last year, Congress passed legislation that placed a limit on the filing of Postal Savings Account claims to July 13, 1985. We have received the cooperation and support of the U. S. Postal Service in advertising the filing limitation, and will close out the account after July 13th.

Administration

The administrative cost of operating the Service is allocated among the four activities on a pro rata basis reflecting actual use.

During fiscal years 1984 and 1985, the Service began to upgrade its security function. The framework for the security function will be a comprehensive plan covering an evolutionary development of an effective security program on a coordinated Servicewide basis. This program will address all aspects of security including personnel and system integrity, physical security, and emergency preparedness.

Mr. Chairman, as stated earlier, our FY 1986 budget increase is $5.3 million. We are requesting this funding increase primarily to implement short-term improvements and to continue developmental and systems design efforts for long-term projects. The total amount of program changes identified in our budget for FY 1986 is $14,126,000 and it supports the Service's goals of assuring the effective and efficient operation of Governmentwide money management, payment, collection and delivery systems.

For FY 1986 we have identified six major initiatives:

1. Computer Support for Check Payment and Reconciliation and other systems

This effort will provide the Service with the computer resources necessary to accomplish our essential requirements for Governmentwide financial operations. Currently, another agency is providing computer timesharing support for the development of the redesigned Check Payment and Reconciliation system. We estimate that when the conversion of this system to our own computer is complete, it will yield a cost avoidance of approximately $20 million over a 5 year period.

2. Collection and Payment Mechanisms

This is a series of five efforts that are designed to improve the system for collection and payment of Federal funds.

These efforts include the following: a) the ability to convert income tax refund checks to Direct Deposit; b) the conversion of vendor payments to the Automated Clearing House System; c) the redesign and standardization of claims software in each Financial Center resulting in operational efficiencies; d) the establishment of a modernized collection system to accelerate the collection of funds owed the government (This effort will result in annual interest saving of $276 million); and e) the development of controls, procedures and systems capable of certifying and monitoring Federal grant, loan and bill paying practices.

3. Government On-Line Accounting Link (GOAL)

This project will expedite the collection and reporting of financial information. Currently, the GOAL project enables agencies to telecommunicate the monthly Statement of Transactions Report. Today, 852 of 875 agency accounting offices nationwide have connected on-line to the system. During 1986, the system will be expanded to cover all agency financial reporting to our central accounting function, all reporting from Headquarters and Regional Financial Centers to agency accounting offices and the beginning of a fully automated interagency billing and collection process. It is expected that savings of 40 staff years in Government agencies will be realized due to automated accounting input and agencies having access to an automated data base. Other benefits include timeliness and accuracy of data, minimal reprocessing, and elimination of over 100,000 pages of printed reports.

4. Financial Center Telecommunication Network

This network will provide a basic telecommunications link between Headquarters and the Regional Financial Centers. This project addresses the problem of timely information flow among various locations and financial systems.

5. Security/Financial Integrity

Our large volume of checks, electronic funds transfer payments, data transmissions, claims actions and funds accounting requires that we give security a very high priority. This project will allow progress in the physical security

program Servicewide in order to reduce the vulnerability of our operations to fraud, waste and abuse. Part of the funds, requested will also be used to support the Federal Managers' Financial Integrity Act in compliance with the Congressional mandate.

6. Human Resource Utilization

The Service wants to ensure that employees are equipped to handle and provide for the expansion of services and workloads in a changing work environment. In this regard, the impact on morale is critical. The Service is undergoing and will undergo major changes in its operation. Employees realize that their familiar ways of working are changing and that they must learn new, more challenging methods. Under these conditions, the Service believes that if it expects its employees to accept these challenges, it must help them to upgrade their skills.

Summary

As the volume and dollar amount of Federal financial transactions continues to grow, the Service must be prepared to meet the challenges of operating sound financial systems utilizing current computer and telecommunications technologies. Our return on investment is increasing annually due to the implementation of Reform 88 initiatives and the improvement of Governmentwide financial systems.

We look upon our budget request of $248,121,000 and 2,300 average positions as an investment in sound financial management that will yield continued growth and savings to the Treasury, the Government and, most importantly, the American people.

Mr. Chairman, your continuing confidence and support of our Services programs are appreciated. I will be happy to answer any questions you may have.

Mr. BISHOP. The Office of the Secretary has the important mission of providing support to the Secretary in his roles as chief financial officer of the Government, major policy adviser to the President, and Executive Director of the Treasury Department.

The Office of the Secretary's fiscal year 1986 budget request totals $76.7 million, 1,245 positions, and 1,188 average positions. Of this amount, $22.4 million will support the broad economic policy direction activities within the Office of the Secretary. These include development of tax initiatives, economic forecasts, and fiscal policy, including management of the public debt and management of the production of coins, currency, and postage.

An estimated $4.4 million will support the inspector general function for the Department's nonlaw enforcement bureaus.

Approximately $13 million will support international activities, such as international monetary affairs, development financing, and trade and investment policy.

An estimated $27.9 million is for departmental policy and administrative functions, such as budget, accounting, personnel, and procurement. I should point out that, among the major departments, this is among the smallest level of resources for such functions.

Approximately $8.3 million will be used to maintain, operate, and improve the Main Treasury and Annex Buildings. As you know, the Office of the Secretary is unique because we own and operate our own buildings—Main Treasury and the Annex. Unlike most Federal agencies, the Office of the Secretary must budget funds specifically for the general operations of its buildings. These are funds that otherwise would be paid to the General Services Administration.

General support operations include maintenance and repairs, utility services, and payments for rental space for OS staff housed in commercial office space. Our fiscal year 1986 request includes $0.7 million for repairs and improvements. Our total request of $76.7 million includes no programmatic increases. The only additional resources requested are $1.1 million in inflationary increases for the annualization of the fiscal year 1985 pay raise.

This increase is offset by decreases of $3.4 million.

The decreases include a reduction of $2 million as the result of the administration's proposal to reduce civilian pay by 5 percent and a $1.4 million decrease in administrative overhead.

In conclusion, the fiscal year 1986 request for the Office of the Secretary is an austere budget, consistent with the administration's objectives to reduce the Federal budget deficit by reducing the cost of Government operations.

Thank you for your consideration of our fiscal year 1986 budget request and for your ongoing support of our ADP and building renovation efforts, which will be continued within the resources requested.

I will be happy to answer any questions you may have after Assistant Secretary Dineen and Mrs. Ortega summarize their statements.

Senator ABDNOR. Mrs. Dineen.
Mrs. DINEEN. Thank you, Mr. Chairman.

FINANCIAL MANAGEMENT SERVICE

I appreciate the opportunity to discuss the fiscal year 1986 resource requirements of the Financial Management Services and the Bureau of Public Debt.

I will first cover the Financial Management Service.

Last year, Secretary Regan approved changing the name of the Bureau of Government Financial Operations to the Financial Management Service, and this was intended to reflect the greater emphasis and recognition that is being placed on Federal financial management.

In recent years, the Service has undertaken an ambitious modernization effort to ensure that payments are made in the most effective and cost-efficient manner, that collections are optimized, that Government funds are managed prudently, and that the Governmentwide accounting function is carried out in a timely and accurate manner. In fiscal year 1986, we are continuing to build and expand upon our earlier developmental efforts. When fully implemented, these modernization efforts will generate interest savings of over $1 billion annually, a return on investment which is very high. Because of these savings, the Treasury Department identifies the Financial Management Service as a profit center rather than a cost center.

The fiscal year 1986 resources will provide necessary computer support for the redesigned check payment and reconciliation system and many of our other systems; will provide enhanced security for computer and funds transfer systems, as well as our financial centers, and will continue the cash management improvement programs. In order to accomplish these goals, we have identified the fiscal year 1986 resource requirements as $248,121,000 and 2,300 average positions.

Senator ABDNOR. You may proceed.

This is for the record. I have to appear before another committee to get in a question but I will be right back.

BUREAU OF THE PUBLIC DEBT

Mrs. DINEEN. I now turn to the Bureau of the Public Debt. For administering the public debt of the United States, we are requesting an appropriation of $197,225,000 in fiscal year 1986. This Bureau's request reflects a significant savings resulting from several improvements in management systems. The savings are indicative of the Bureau's commitment to improving its operations through automating securities handling processes and enhancing internal controls. This year's request reflects major savings resulting from instituting full book-entry for marketable securities. The move to full book-entry is significant because it provides improved service and reduced risk of lost securities to investors as well as cost savings to the Bureau. Net cumulative savings in excess of $67 million will be realized over 7 years as the new system is phased in.

Improvements continue to be made in the Savings Bonds Program, also. For example, our fiscal year 1986 budget requests funding to purchase high-speed data capture equipment to process savings bond issues. Significant savings are projected in fiscal year 1987 due to the application of the improved technology. Funding for a new computer is also requested which will improve both the Savings Bond and Marketable Programs in the years to come.

That concludes my prepared statement on the fiscal service appropriations. Mr. Chairman, I will be glad to respond to any questions that you and members of the subcommittee may have.

U.S. MINT

Mrs. ORTEGA. Mr. Chairman and members of the committee, I am pleased to appear before you today to testify on the U.S. Mint's and U.S. Savings Bond Division's fiscal year 1986 budget requests. I am accompanied by Donna Pope, Director of the U.S. Mint and Steve Mead, Executive Director, U.S. Savings Bonds Division.

This year's salaries and expenses appropriation request for the U.S. Mint is for $46.954 million and 990 average positions, which is a decrease of $804,000 and 30 average positions from the fiscal year 1985 continuing resolution.

The mint is planning production of 16.2 billion domestic coins. This domestic coin production combined with an inventory reduction will meet the Federal Reserve's needs.

There are several initiatives included in this request which begin a multiyear improvement plan for the mint. Specifically, requested funds will support a Research and Development Program, space planning at the Philadelphia Mint, and coin production equipment investments.

I am pleased to report on the success of the Olympic Coin Program. As of January 31, 1985, over $69.8 million has been provided to the U.S. Olympic Committee and the Los Angeles Olympic Organizing Committee for support of our Olympic efforts. Exceeding our goal of raising $65 million is a significant achievement for all involved with the program.

Several new commemorative and bullion coin programs have been introduced in this session including legislation to produce a Statue of Liberty-Ellis Island commemorative coin.

SAVINGS BONDS DIVISION

The mission of the U.S. Savings Bonds Division is to reduce Federal spending by promoting the sale and retention of U.S. savings bonds.

Savings bonds are particularly important now because they are the most cost effective way the Treasury has to finance the public debt. We estimate that bonds are 2 to 2½ percentage points less costly than marketable debt of the same maturity. This translates into interest costs savings of nearly $2 billion in fiscal year 1984 based on the $73.7 billion dollars in bonds outstanding, and we expect even greater savings in fiscal year 1985.

In addition to helping the U.S. Government finance its debts in the least expensive way possible, the program provides an opportunity for millions of American savers to participate in the financing of their Government and to develop habits of individual thrift which contribute to our broader economic objectives of increasing savings and reducing inflation.

FISCAL YEAR 1986 APPROPRIATION REQUEST

For fiscal year 1986, the Division is requesting $17.4 million and 273 FTE positions. This request is a net decrease of $327,000 and three FTE positions from the authorized level for fiscal year 1985.

In order to operate most effectively with reduced funding, the Division will continue to rely heavily on unpaid volunteers from banking, business, and industry. Volunteers who know savings bonds appreciate their benefits and welcome the challenge of leadership in a worthy cause. Outstanding leaders from many fields of endeavor make up the working committees whose services are utilized at the National, State, and local levels.

During fiscal year 1986, the Division will continue to concentrate its efforts on achieving the greatest possible sales growth and building its key markets, especially payroll savings. Efforts will be concentrated on those accounts which offer the greatest sales potential in order to make the most cost effective use of existing staff and volunteer resources.

Mr. Chairman, this concludes my prepared remarks. We will be glad to answer any questions you may have.

Mr. PARKINSON. I want to thank you for your statements. I think we will proceed with committee questions until the Senator returns.

First of all, before we even get into the budget, can you give us an update on the move to Hyattsville and where we sit and how things are progressing.

FMS MOVE TO HYATTSVILLE

Mr. BISHOP. The Financial Management Service has reached an agreement with the General Services Administration to lease approximately 187,000 square feet of the Hyattsville facility at Prince Georges Plaza. That will result in the movement of approximately 1,074 of FMS personnel to Hyattsville. As I said, we have an agreement with GSA on the subject. GSA has agreed to construct a computer facility out there to house the headquarters computer and will actually help fund movement of the service. One thing we still have pending is a fiscal year 1985 supplemental request to purchase systems furniture to be able to utilize the space in Hyattsville effectively. That supplemental will be coming shortly.

GAO FACILITY

Mr. PARKINSON. How about the facility at GAO? Have you had any luck with the increased number of square feet that you were originally requesting?

Mr. BISHOP. The Washington Financial Center, a facility of approximately 60,000 square feet will remain at the GAO Building. We have no intention of moving that.

Mrs. DINEEN. The Washington Financial Center will remain in the GAO Building because we regard that as a field installation, just as if it were in Austin, TX; however, part of the agreement with GSA is that we would find a building somewhere in which to consolidate the remainder of our headquarters operations, thus freeing up space in the Annex, the Treasury Annex, and allowing Treasury staff now in leased space to move into the space that Treasury owns. We have not identified a specific building, but we have agreed to this in principle. So it is really a package deal, if you will. It is more than a move to Hyattsville.

INTERNATIONAL ACTIVITIES IN OS

Senator PROXMIRE. Thank you. I apologize for having to go to the floor and for staying so long. There were a couple of Senators ahead of me. They should not have been but they were.

Despite your efforts to cut the Office of the Secretary budget by about $3 million below last year's level, the Office of the Secretary budget has grown about 37 percent since this administration took office. Your fiscal year 1981 budget was about $56 million and your 1986 request calls for about $76.7 million.

About $13 million of your fiscal year 1986 request is for international affairs activities, including $1,987,000 for so-called Arabian Peninsula affairs.

What activities are covered by this subaccount, and why? In light of our need to hold down spending even further, couldn't we cut your international affairs budget back below your fiscal year 1985 Level?

Mr. BISHOP. The international affairs activity includes, OS activities associated with Treasury's international economic affairs responsibilities, such as those involving the International Monetary Fund. The Arabian Peninsula subactivity deals with the Saudi Arabians and other countries of the Arabian Peninsula on monetary and financial issues. I will provide you with more information for the record.

Senator PROXMIRE. I appreciate that. I think you and your office understand better than anybody in Government about how to hold spending down. I notice in general that this administration has been surprisingly generous in the area of foreign aid of all kinds. This is a little different. It is a multinational international organization which I strongly support.

[The information follows:]

INTERNATIONAL AFFAIRS BUDGET

INTERNATIONAL AFFAIRS ACTIVITIES

The international affairs activities within the Office of the Secretary [OS] incorporate a wide range of functions that are crucial to the conduct of U.S. foreign economic policy. The OS supports the Secretary of the Treasury in achieving the goals of: the operation of a stable and smoothly functioning international monetary and financial system

that is consistent with and supportive of U.S. economic and financial interests; the maintenance of an open international trading and investment system which is fair, and consistent with U.S. domestic and other international economic policies; and the formulation of U.S. economic policy toward developing countries that is consistent with our overall domestic and international economic policy and with the United States' broad foreign policy objectives.

The Treasury has a number of policy and program responsibilities with regard to the countries of the Arabian Peninsula and to international energy policy. In fiscal year 1986, the budget request for the Arabian Peninsula affairs deputate is 33 average positions and $1,987,000. These resources will be used to address three major responsibilities:

Economic and financial analysis of the Arabian Peninsula countries, financial analysis, and projection of OPEC and other oil revenues, and participation in the formulation of international energy policy.

These analyses address such issues as the impact of world energy developments on world and U.S. inflation, growth, country balance of payments situations, and the international financial system. In addition, the staff reviews energy finance and investment issues, particularly Multilateral Development Bank [MDB] activities for lesser developed countries' [LDC] energy resources development, and helps formulate the U.S. Governments' energy policies for multilateral fora, such as the International Energy Agency [IEA]. Eight positions and approximately $500,000 will be used for this unit.

The United States-Saudi Arabian Joint Commission on Economic Cooperation and the 28 projects it has initiated to transfer the knowledge necessary to run a modern government to the Saudis. This program was established in 1974 and is completely financed by the Saudis, with the exception of eight managerial personnel—four in Washington and four in Riyadh—whose responsibility is to represent the U.S. national interests in the management of the joint commission. Total expenditures for the eight U.S. Government personnel in this activity will be approximately $550,000. There are more than 200 U.S. Government personnel from 12 U.S. Government departments and agencies who participate in these projects in Saudi Arabia, with an additional 20 here in Washington. Total expenditures through December 1984 have amounted to $1.1 billion, all from Saudi Arabia; and

Three mandatory reporting systems which track the international financial activities of U.S. banks and business firms and compile information on all debts owed to the U.S. Government by foreign governments, including overdue debts. This responsibility also includes computer-related services to other offices in OASIA. Seventeen positions and $950,000 will be used for this activity.

FISCAL YEAR 1986 BUDGET REQUEST

The fiscal year 1986 budget request for the international affairs activity within the OS is 237 average positions and $12,977,000. The fiscal year 1985 level of resources authorized for international activities is 236 average positions and $13,145,000. The reduction of $186,000 requested in fiscal year 1986 is the net effect of the proposed 5-percent pay reduction and the annualization of the fiscal year 1985 pay raise. The OS has not requested any other program or inflationary increase.

Reductions in staffing and resources below this level would seriously hamper international activities of the Treasury Department. Since the Reagan administration came to office, the staffing level for the international affairs activity has declined from over 300 to about 250, at a time when this country's international economic activities have expanded greatly. Since approximately 80 percent of international affairs' total funding is utilized for personnel compensation, a further cut in the international affairs budget in fiscal year 1986 would require an additional cut in the economic staff. The result would be that the ability of international affairs to perform its functions in support of the Secretary of the Treasury in the international area would deteriorate significantly. Areas of substantive concern would be reclassified as lower priority and would no longer receive meaningful attention. Response time to emergencies and regular requests would slow. Staffing vacancies would remain unfilled as we would probably have to restrict or freeze personnel hires.

CONSULTING SERVICES

Senator PROXMIRE. In your justifications, you indicate that you plan to spend $1,192,000 on consulting and related services—about the same as last year and about $100,000 more than fiscal year 1984.

According to your budget book, $848,000 of this amount would go for special studies and analyses. You give some general outline of the type of special studies and analyses you might do next year, but you aren't specific.

Can you tell us what specific studies you plan to pay for next year and, again, in view of the tremendous deficits, why can't we eliminate or sharply cut your consulting service request in fiscal year 1986?

Mr. BISHOP. Some of these studies deal with economic issues. The Office of Tax Policy uses consultants in its work quite a bit. It's difficult to predict what specific studies will be done next year, since issues vary from year to year but the general issues studied each year are the economic and tax areas.

Senator PROXMIRE. For the record, can you give us the specifics.

Mr. BISHOP. Yes.

OS also has some open contracts through which contracts are awarded to several companies for management analysis services but no specific tasks are assigned until the contracts are actually needed and utilized.

Senator PROXMIRE. Let me ask Mr. Mills to follow up on that.

Mr. MILLS. Perhaps you could provide some specifics as you did with your special studies in fiscal 1984 where you have actual experience and any studies you awarded in 1985 to give the subcommittee some idea on what you are spending it.

[The information follows:]

CONSULTANT SERVICES CONTRACTS

The Office of the Secretary [OS] uses consultant services contracts for special studies and analyses in the area of economic analyses, mathematical and statistical analyses, and the overall management of the Department. In fiscal year 1984 contracts were awarded for the following studies:

	Amount
Treasury Operations Center	$447,000
Contract for the architectural and engineering design for the development of the Treasury Operations Center.	
Master correspondence tracking system	130,000
Contract to develop a system to track and control executive correspondence.	
Resource allocation model	94,000
Contract for development of a source model which contains alternative approaches to processing inventories in IRS enforcement operations.	
Foreign portfolio investment survey	81,000
Contract for development of computer program to compile data on foreign holdings and investments in the United States.	
Telecommunications engineering services	80,000
Provision of professional services for systems engineering review of the existing telecommunications network and development and implementation of a future telecommunications network design.	

	Amount
Treasury direct access book-entry system Project to provide OS review of systems design of Bureau of Public Debt tracking system on book-entry bonds, securities, notes.	$20,000
EEO decision writing Contract to provide written decisions on 75 EEO complaints within the Department.	11,000
Total fiscal year 1984	863,000

In fiscal year 1985, as of April 5, 1985, the following consultant services contracts have been awarded:

	Amount
Treasury Operations Center A continuation of the fiscal year 1984 contract for architectural and engineering design for the development of the Treasury Operations Center.	$631,000
Foreign portfolio investment survey A completion of computer software design to compile data on foreign investments in the United States.	81,000
Federal financial systems of the future Contract to perform a survey of high level Federal officials to obtain their views of Federal financial systems and then develop a strategy to improve these systems. This project is being performed on behalf of the systems committee of the President's Commission on Management Improvements.	13,000
Total fiscal year 1985	725,000

OFFICE AUTOMATION

Senator PROXMIRE. I notice that your equipment budget for the Office of the Secretary increased a dramatic 193.3 percent since fiscal year 1984—from $2.3 million to $6.8 million next year. During this same timeframe, your positions have gone down.

Is there a direct correlation between your equipment purchases and your ability to get along with fewer people? If not, why the huge jump in equipment since fiscal year 1984?

Mr. BISHOP. Yes; this is one reason for the increase in the equipment line. We are attempting to introduce automation in the Office of the Secretary and this is one area that contributes to lower employment. We see a direct correlation in the amount of office automation we can introduce and the computer support we can provide with the lowering of staffing levels.

I think we also increase the effectiveness of our professional employees through the use of our office automation equipment.

Senator PROXMIRE. Does this mean in the long run you will be able to cut spending more than you could if you had not had the equipment?

Mr. BISHOP. Yes; and this is the result of the introduction of a great deal of office automation in the Office of the Secretary.

Senator PROXMIRE. This is a question for the U.S. Mint.

MINT—OTHER SERVICES

I notice in your object class tables that your other services budget has more than doubled since fiscal 1984—from $1.8 million to $3.7 million in 1986. I also see your equipment budget increases by more than 134 percent between 1984 and 1986—from $1.9 million to $4.4 million next year.

Why have you experienced these rather dramatic increases in other services and equipment over the past few years?

Ms. POPE. The increased portion in 1986 is for seven additional coin presses for our Denver Mint. That is to anticipate the rise in demand for coin production. The increase in other services relates to the Research and Development Program.

Senator PROXMIRE. As far as the public debt, could I ask about that. I notice in your justifications you will require an additional $1 million for printing annex, increased training costs, and increased reimbursement in the Financial Management Service for General Electric employees. I was under the impression that the Bureau covered its own costs and I would like to know why General Electric, an outstanding company in my own State of Wisconsin, is singled out on savings bonds.

Mrs. DINEEN. I will have to supply you something for the record.

Senator PROXMIRE. I am surprised the company is singled out and we are proud of it.

Mrs. DINEEN. I am sorry; I can't address that. As far as the space we lease out of the Bureau of Engraving and Printing, this figure includes cleaning and maintenance services as well as the cost of space rental.

Senator PROXMIRE. For the record, if you could let us know what you can, we would appreciate it.

[The information follows:]

A portion of the Bureau of the Public Debt is housed in the Engraving and Printing Annex. The Bureau reimburses the Bureau of Engraving and Printing for maintenance costs of that portion of the building. These reimbursements include housekeeping services, elevator and guard services, steam and electricity, and minor maintenance costs.

The General Electric Co., has a Savings and Security Program for its employees. General Electric initially purchases savings bonds in book-entry form for this employee program. When savings bonds are distributed to employees under this program, they are individually inscribed and issued by Treasury's Philadelphia Disbursing Center. The Bureau of the Public Debt reimburses the Disbursing Center for their costs of performing this service similar to the way that the Bureau compensates other financial institutions for issuing savings bonds.

SAVINGS BOND DIVISION SALES FORCE

Senator PROXMIRE. In the Savings Bond Division, you plan to spend $13.8 million for a 231 sales staff in the Savings Bond Division. You are also asking for a public communications budget of $1,772,000. Do you really need a large sales force to promote savings bonds? Couldn't you more cheaply reach millions more people if you put some of that $13 million into advertising rather than having a sales staff?

Mrs. ORTEGA. We make use of the sales force and depend very heavily on volunteers. All of the advertising is public service-type adver-

tizing. We are considering streamlining our advertising material and will be during this next fiscal year using the same spots for a longer period of time. Rather than producing more spots, we will be using them for a longer period of time.

Senator PROXMIRE. As you may or may not know, I am a Democrat and I would be willing to vote 30-second spots for President Reagan or Vice President Bush if it would do more than just sign up a few GE people for the Savings Bond Program. I would not like to give those distinguished gentlemen any more publicity than necessary, but I think it would sell savings bonds.

Mrs. ORTEGA. We have received support from the President that has been very effective and he has done some publicity spots for us which we have used for different groups. That is something we have considered and will probably pursue it again this year.

SOUTH AFRICAN KRUGERRAND

Senator PROXMIRE. Mrs. Pope, I have introduced a bill calling for the creation of a 1 ounce bullion coin to compete with the South African krugerrand. What is your position on that?

Mrs. POPE. Senator, I will have to defer to Treasurer Ortega on that question.

Mrs. ORTEGA. I did not hear your question, Senator Proxmire.

Senator PROXMIRE. I have a bill calling for a 1 ounce gold coin to compete with the South African krugerrand. There is no reason we should be helping their exchange. What is your position on that?

Mrs. ORTEGA. It is presently being studied at the Department level, and we have not established a position on that. We will be getting back to you on that.

Senator PROXMIRE. I honestly hope you will consider it. We all know how we deplore apartheid and the absolutely outrageous slaughter of innocent people in South Africa. It seems to me this would be a perfectly reasonable and proper way to show our feelings.

When do you expect to be able to get back to us on that?

Mrs. ORTEGA. I will get back to you in the next week or two.

Mr. PARKINSON. Senator Abdnor is at another Senate committee hearing. He expects to be able to return shortly.

Senator PROXMIRE. I have to leave.

IMPACT OF 5-PERCENT PAY CUT

Mr. PARKINSON. The budgets in all of the accounts in the Office of the Secretary assume the 5-percent pay cut. What impact on each division would result if the pay cut was not enacted, but no funding was provided to cover the projected savings?

Mr. BISHOP. Obviously, we have not done a complete analysis of that, but we are certain some programmatic cutbacks would have to be made in areas such as travel. A possible hiring freeze would also be considered if that happens. A reduction of this size would have a severe impact on the Office of the Secretary because of the degree of the cuts we

have already taken. Reductions beyond those already included in our request would be very severe.

Mr. PARKINSON. Would you keep the committee posted on that because there are a lot of other agencies in the bill. It appears there would be possible adverse personnel problems that might be created.

The Department has requested and the committee has approved significant levels for upgrading ADP requirements over the last 4 years. No one will argue the need for state-of-the-art equipment. It provides the means to better manage plus, more importantly, make money for the Federal Government. Where are we in the master plan? Will we ever have a handle on ADP management?

ADP MANAGEMENT

Mr. BISHOP. I think we now have a handle on it. If the question is when do we stop modernizing, I hope we never stop modernizing. That is one of the difficulties we have had in the past. Previously we stood in place and let the technology pass us by. The information systems plan we have in the Office of the Secretary now enables us to stay current with the industry, and the hardware and software we are installing is the most modern we can obtain. Our plan calls for a continuing replacement of the older equipment, so that we never get ourselves in the position of having obsolete equipment.

Mr. PARKINSON. We don't want to see it get back to the problems we faced a few years ago.

TRANSFER AUTHORITY

The Treasury Department currently has a 1-percent transfer authority. Your fiscal year 1986 budget requests a 5-percent authority. Give the committee the justification for a 5-percent authority and the reason for that dramatic increase.

Mr. BISHOP. It gives the Secretary that much more flexibility in transferring funds across appropriation lines when necessary. As you know, the Department has a considerable number of appropriations, and there are restrictions on the Secretary concerning the movement of funds. We feel the current transfer authority of 1 percent is a little more restrictive than we need to have, and the 5-percent transfer authority would give the Secretary a lot more flexibility.

MANAGEMENT SAVINGS

Mr. PARKINSON. Modernization is slated to generate savings of $1 billion a year when fully implemented. How long will completion take and what will generate these savings, and are we incurring any savings at this time and will that gradually increase?

Mrs. DINEEN. The savings have been increasing year by year as we started off with Reform 88. The way we are generating the savings is by putting good cash management practices into place, working with 20 major departments and agencies to change the way they collect Government funds and change the way they pay out Government funds. We

also use existing bank services provided by major commercial banks, just as those banks provide services to major corporations.

Let me just give you a history of this. In fiscal year 1984, we generated interest savings of over $600 million, rising in 1985 to $821 million and in 1986 to $1.1 billion. I don't think fiscal year 1986 is the end of that upward curve. I think you will continue to see greater savings as we implement all the various elements recommended in the payments and collections study that we carried out in 1983.

FULL BOOK-ENTRY

Mr. PARKINSON. The full book-entry changes will generate savings of $67 million over the phasein period. Will there be further savings or where will we be at the end of that 7-year period?

Mrs. DINEEN. That is the life-cycle savings. Obviously, to the extent that full book-entry reduces your need for people, which it does, those savings will continue on over the out-years. But when you calculate the savings for a system, we do a 7-year life cycle.

COMMEMORATIVE COIN PROGRAMS

Mr. PARKINSON. Commemorative coin programs are once again on the increase. One that comes to mind is the Statue of Liberty, Ellis Island. Where are we with this project and is there any projection on what the sales will generate?

Mrs. ORTEGA. The bill was passed by the House and we are waiting for the Senate to act on that. We have just done preliminary figures on that, and I don't have anything for the record at this point.

Mr. PARKINSON. Generally, are the commemorative coin programs cost effective?

Mrs. ORTEGA. As of January 31, we turned over $69.8 million to the Olympic committees. A program of that magnitude had never been handled by the Department of the Treasury previous to the Olympic Program, and we feel it was a successful program and it certainly provided funds to the Olympic committees. The purpose of the Statue of Liberty Program is to provide funds for the restoration of that Statue of Liberty at Ellis Island.

PAPER CHECK

Mr. PARKINSON. What has been the reaction to the new paper check?

Mrs. DINEEN. We don't have a great number of checks out yet. The pilot is going to involve 5 million IRS refund checks and a couple of hundred thousand Social Security checks in the Philadelphia area. We did get a lot of good coverage in those areas and people seemed to be aware of what was happening. The checks did go through the banking system with no trouble, and I think it is safe to say that the pilot is successful.

Mr. PARKINSON. The plan is that the complete conversion will be completed in fiscal 1986?

Mrs. DINEEN. Almost. The Social Security payments will go nationwide in December 1985 and then there will be some more conversions in fiscal 1986. There will be some spillover into early fiscal 1987, converting the last of the civilian retirement checks and vendor payments, but the bulk of it will be done, yes, by the end of fiscal 1986.

CHECK PRINTING COST

Mr. PARKINSON. Printing and mailing of checks is still a huge expense even though the effort has been made on direct deposit electronic funds transfer. What does it currently cost to print a check today?

Mrs. DINEEN. The cost of printing and mailing of a check is 26 cents versus 3 cents for direct deposit payment. Clearly direct deposit is much more cost effective.

DIRECT DEPOSIT

Mr. PARKINSON. Does the Department have a master plan to try to promote a bigger and better effort toward direct deposit funds transfer?

Mrs. DINEEN. We are doing some pilot work this year. We are trying to experiment with an 800 number where people could call in and sign up for direct deposit to see what kind of response we get to that. We feel that one of the impediments to signing up for direct deposit is that the enrollment procedures areto do so cumbersome. We want to see how much we can streamline the enrollment procedures to see how much that will help our marketing efforts.

We also plan to introduce legislation authorizing the Secretary of the Treasury to require that wages and salaries of Federal employees be paid by direct deposit. We have some exemptions included in the legislation so that people would not be harmed. For example, we would provide that current employees who earn less than $25,000 would only have to sign up on a voluntary basis. All future employees would be required to sign up for direct deposit.

SAVINGS BONDS

Mr. PARKINSON. In the savings bond area, the statement indicates that you are going to be reducing some positions and indicate that you will rely more and more on volunteers. Is it a realistic assumption we will see a better approach to sales?

Mrs. ORTEGA. We have used volunteers over the years. With the change in savings bonds where we are now offering a competitive savings bond with the market-based rate, we found the volunteers to be even more enthusiastic in supporting our product, so we feel that it is realistic to expect further support from the private sector.

U.S. MINT

Mr. PARKINSON. The mint will reduce its coinage and drawdown from existing stocks in fiscal year 1986. Is this the first time this type of action has been taken and have you any projections about the possible adverse effects of the basic inventory?

Ms. POPE. No; it is not really the first time it has been done. In the early 1980's, the inventory was drawn down dramatically because we were dealing with a penny shortage. Since then we have seen a flattening out of coin demand so our inventories have been growing. Rather than causing a problem, the drawdown will actually help us because we will not have to deal with storing as large an inventory as we have now. We do not anticipate any adverse effects at all.

Senator ABDNOR. Is this any reason for the lesser use of coins?

Ms. POPE. Senator, we really don't know. We see a lot of the lessening of demand in the penny area and we can speculate on a number of reasons, one being the change in the alloy. Also, we finally saturated the market enough so that the banks are comfortable with the availability and are now circulating pennies between themselves.

Recent legislation has made banks much more cost conscious and as a result the coins are circulating between commercial banks in a more fluid way. But all this is just speculation on our part.

We have recently awarded a contract to a consulting firm to take a total look at what is happening to coin demand in the United States. Throughout the world, as well as in the United States, coin demand is lessening.

Mr. PARKINSON. What are current storage costs for the coin inventory? Could you provide that for the record. Is there an ongoing amount of the budget that is allotted for that?

Ms. POPE. Under normal circumstances, there is not an ongoing amount budgeted for storage costs. Because of Expansion and Improvement Program going on now at the Denver Mint, we were not able to store coins there because much of the vault space was being used for other materials or was not available due to construction. As a result, we have been storing those coins in an offsite place. Our cost for this is about $360,000 for storage and the transportation of coins.

MINT EXPANSION

Mr. PARKINSON. Expansion has been conducted at both the Denver and Philadelphia Mints. Is that going to solve the capacity problems and how long do you project these changes will meet coinage needs?

Ms. POPE. When the Denver expansion is completed, we will have a capacity for 22½ billion coins. Presently we are projecting the coin demand to be 18.4 billion in 1986. So, we think we will have capacity for at least another budget year or two. We are looking at various configurations of the mint as a whole, to determine the best future use of all of our space. But with the expansion at Denver and space becoming available at Philadelphia, we really do not anticipate the need for any new facility until the far distant future.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. We have other questions. If it is all right with you, we will submit them to you in writing. We do appreciate all of you being here. I am sorry I had to run out on you for a few moments, but we are spread rather thinly around here.

I want to thank all of our witnesses for their testimony. I need not tell you that coming up with the budget this year is not going to be easy, so we appreciate your testimony.

I can assure you that the part that goes into the record we will look over very careful and help to stay within the confines of what they tell us we have to do. Ever since they started trying to reduce spending in budget and slowing down the increase, this particular section of the Appropriations Committee is probably more under the gun than many because we are in one of the discretionary areas of that budget. We hope we can do right by you this time and we appreciate your testimony today.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

SAVINGS BONDS TRENDS

Senator Abdnor. Savings Bonds are the most effective way for the government to service debt. The public has been very receptive in participation. Could you briefly give the committee an idea of trends?

Mrs. Ortega. Sales have risen consistently since the market-based interest rate was implemented on November 1, 1982, with the exception of the three-week suspension of sales when Federal borrowing was halted in November 1983. Beginning with fiscal year 1983, the amount of Savings Bonds owned by Americans has risen more than $7.5 billion, from $67.6 billion to $75.1 billion. These bonds replace marketable debt at an estimated annual saving of almost $2 billion. The growth since October 1982 has increased the annual savings to the Treasury by nearly $200 million.

Fiscal year 1983 sales were 29% above the 1982 level, while redemptions were down 31% during the same period. Fiscal year 1984 sales dropped 2% as a result of the November 1983 suspension. During most of fiscal 1984 sales were 5-10 percent above 1983 levels.

Through February of fiscal year 1985 sales totals were 10% above 1984 and 34% above the same period in FY 1982, the last year of fixed interest rates. Redemptions were virtually identical to 1984 and 38% below 1982 levels.

GALLUP SURVEY

Senator Abdnor. A survey was recently conducted to assist the Division in marketing bonds. What did we learn? How are you implementing the recommendations?

Mrs. Ortega. The survey was conducted in October 1983 to determine consumer awareness of the market-based rate for Savings Bonds with particular attention to the communications media which had the greatest impact on consumer awareness and the effectiveness of various promotional strategies of the Savings Bonds Division.

The survey provided information on consumer attitudes toward Savings Bonds and potential new markets or marketing approaches for Savings Bonds.

The Division learned that eighteen percent of respondents had heard of the new market-based interest rate, but only four percent were able to identify this important change without prompting. Over half of the current payroll savings participants were aware of the rate and no other group was as well-informed. A large majority of respondents thought favorably of the change. One-fifth were more likely to buy Savings Bonds as a result of new market-based rate.

The recommendations are being implemented by continuing to stress payroll savings as the proven most effective means to educate and motivate savers and advertising the rate more forcefully as opposed to other more traditional benefits of Savings Bonds, based on consumer responses. The Division has made major changes in its campaign strategy, including a change in advertising agencies.

PRODUCTION OF PENNIES

Senator Abdnor: By far the largest number of coins produced is pennies. What percentage of your workload and costs does this represent? This no doubt will continue to grow, will it not?

Mrs. Pope: In FY1986, 12.1 (75%) of the 16.2 billion coins to be produced will be pennies. Appropriated funds budgeted for producing pennies is $18.8 million (54% of coinage costs) or 40% of the appropriation request of $46.954 million. Budgeted production of pennies compared to FY1984 will decrease. However, it is anticipated that future production for pennies will increase, but that pennies will be a smaller percentage of total production.

GENERAL CONDITION OF MINT EQUIPMENT

Senator Abdnor: What is the general condition of the equipment the Mint is currently using? Will it have to be upgraded anytime in the near future?

Mrs. Pope: Much of the Mint's main line production equipment is old and some of it is outdated. We are requesting and will continue in future years to request funds for equipment replacement.

In addition, in the request before you, we are asking for funding for seven new coin presses to complete the Denver expansion.

RESEARCH AND DEVELOPMENT

Senator Abdnor: This budget reflects an R&D initiative for the first time. Could you briefly outline what you will be looking into?

Mrs. Pope: The overall objective of our Research and Development Program is to automate a number of our operations and therefore increase productivity. Nearly all of the equipment being utilized in coin manufacturing operations was purchased years ago and is not considered state of the art. Most importantly, very few operations are automated which results in too many processes that are labor intensive, inefficient, and too costly. The Mint's R & D Program is focusing on these processes, e.g., the Mint is currently engaged in development programs designed to automate the die shop and the counting, bagging, and palletizing of finished coins. It plans to conduct similar programs in materials handling and die polishing in the near future. In addition, we are searching for a faster means of feeding blanks into coin presses, and we hope to find ways to computerize control of coin presses, automate visual inspection of coins and dies, and lacquer numismatic medals.

INVENTORY OF SUSAN B. ANTHONY DOLLARS

Senator Adbnor: If I am correct, we currently have an inventory of almost 360 million Susan B. Anthony Dollars. What

does it cost for storage of this kind of an inventory? Is this cost effective? Will we ever get these coins into circulation?

Mrs. Pope: As of February 28, 1985, the Federal Reserve Banks had 130.0 million in inventory while the Mint had an inventory of 357.4 million Susan B. Anthony Dollars, for a total inventory of 487.4 million. Of the 357.4 million in the Mint inventory, 122.2 million are stored at the Denver Branch of the Federal Reserve Bank of Kansas City; this is presently costing $23,953.68 annually.

At present there is little or no demand for these coins.

NEW MINT FACILITIES

Senator Abdnor: To be realistic we are probably going to need new Mint facilities in the not too distant future. Is Treasury looking into this?

Mrs. Pope: At this time, we see no likelihood of needing a new Mint facility in the near future. We are planning for our long range facilities needs but feel that we can meet requirements for many years in our existing buildings.

SALE OF PROOF AND UNCIRCULATED COINS

Senator Abdnor: The Mint has recently begun to sell Proof and Uncirculated coin sets again. Sales are fairly good I presume. Is this market stable or growing?

Mrs. Pope: The United States Mint has recently reinstated the sale of Uncirculated Coin Sets. The Mint has been selling Proof Coins for years. The Mint expects to sell approximately 3 million Uncirculated Coin Sets and 4 million Proof Coin Sets. These sales will generate approximately $14 million in profit for the General Fund. There is good potential to expand sales and in the near future we hope to expand the sale of these products through consignment to banks and other marketing efforts.

REDUCTION OF POSITIONS

Senator Abdnor: Your FY 1986 budget projects a reduction of 30 positions. Will a RIF be required to meet this reduction? If so, what is the cost?

Mrs. Pope: Although the overall FTE reduction is only 30, it is possible that we may have to conduct a RIF. This is because we have cut back our production at West Point and no longer need the number of full-time permanent employees that are there.

Presently, these employees are working in temporary positions on the Olympic and Gold Medallion programs. When this work ends later this fiscal year, we will have to RIF some employees at West Point. However, if the Statue of Liberty coin program is enacted, these employees could be offered temporary positions. If employees accept these temporary positions, there would not be a RIF cost.

REIMBURSEMENT TO FEDERAL RESERVE BANK

Mr. Abdnor. Reimbursement of the Federal Reserve Bank Operations represents by far the largest part of the Banking and Cash Management resources. What sort of transactions require this reimbursement?

Mr. Douglas. The largest portion of the reimbursement is made through the Federal Reserve Banks to 14,000 commercial depositories for processing federal tax deposits. In FY 1986, $28,174,000 will be paid for this service. Other services for which the Federal Reserve Banks are paid include: maintenance of Treasury Tax and Loan accounts, $7,000,000; processing Federal recurring payments through the Automated Clearing House and performing the related accounting, control and security services, $3,662,000; maintenance of the account established for processing U.S. Iranian Claims, $1,800,000; and processing transcripts in support of the Treasury General Accounts, $700,000.

Mr. Abdnor. Is this procedure the best?

Mr. Douglas. The procedure is dictated by legislation which was passed in 1977 on the Treasury Tax and Loan program. We are investigating options for the method and amount of reimbursement for tax payments in general. We are beginning a long-term review of other options which may have the potential for additional savings/earnings to the Government. Any major redesign of this system, if feasible, is probably 3 to 5 years away and will require the active support of the Congress.

Mr. Abdnor. Is this the most cost effective?

Mr. Douglas. Treasury earns interest on deposits held at commercial depositories through the Treasury Tax and Loan Investment Program. This has already proven to be an extremely profitable method - actual interest earned in FY 1984 was $1.2 billion. Reimbursement to the Federal Reserve Banks allows us, as a paying customer, to request improvements in services provided. As mentioned earlier, we are continuing to look for improvements that will increase efficiency and cost effectiveness.

COMPUTER UPGRADE

Mr. Abdnor. Upgrade of computer capabilities is an ongoing process, and is one that the subcommittee believes is necessary. Hundreds of millions of dollars have been spent at Treasury agencies over the last few years. Are we getting state-of-the-art equipment that will suit our needs?

Mr. Douglas. Funding for computer support for FMS has been very modest over the last five years. We are in agreement with the Committee that our computer acquisition program should stay abreast of changing technology. As an example of this commitment, we recently acquired an IBM 3081 through an interagency agreement with the Federal Home Loan Mortgage Corporation. This is a fourth generation computer and its acquisition was essential if we are to be able to fully support our newly redesigned Check Payment and Reconciliation (CP&R) system which reconciles $600 billion in Government checks each year.

For the paper check conversion, we have begun installation of what we believe to be the best computer directed printing equipment available today.

The only equipment we have procured which is not state-of-the-art was interim ADP equipment for our Financial Centers. As we previously informed the Congress, this acquisition was a stop-gap measure to ensure our ability to continue to issue over 700 million payments each year. We had to move quickly to preserve our ability to issue these payments to Social Security and other benefit recipients, because our existing computers dated back to the 1950's and 1960's.

Next year, we will be requesting funds to replace this equipment in response to greater system requirements, the limitations of the interim system, and an opportunity for further improvement in productivity, security and cost.

Mr. Abdnor. How long will this equipment meet your needs?

Mr. Douglas. The acquisition of the equipment just mentioned will allow us to close the technology gap that has slowed our development for years. We will have state-of-the-art equipment for all our major operations, and through rigorous information systems planning, we will not fall behind again.

IMPLEMENTATION OF COLLECTION AND PAYMENT MECHANISMS

Mr. Abdnor. Several initiatives are talked about in your statement with regard to collection and payment mechanisms. It no doubt will take time to implement. What time frame are we looking at? Do we have any indication as to what public acceptance will be?

Mr. Douglas. The Collection and Payment Mechanisms are in various stages of development and implementation. For example, large dollar vendor payments are now made electronically using the Treasury Financial Communication System. A Treasury lockbox network has been established for the collection of Government payments and is in use. A cash concentration system was

implemented in FY 1984 for payments coming in through the Treasury General Accounts.

A variety of other systems will be implemented over the next several years. We will continue to explore improved techniques and technological advancements into the 1990's.

To date, public acceptance has been favorable. This is consistent with the public's general acceptance of improvements in the Government which help reduce the deficit and save the taxpayer money.

POSITION REDUCTIONS

Mr. Abdnor. Will you require a RIF to reduce the 27 average positions?

Mr. Douglas. No, the reduction will take place through attrition. 19 positions are a result of savings in administrative areas. The other eight positions are a result of productivity savings and continued automation. In fact, over the last four years, we have decreased our average staffing by over 400 positions, and again, doing the job better and more efficiently has allowed us to continue this staffing decrease.

COMPUTER ACQUISITION

Mr. Abdnor. What impact will the purchase of the IBM 3081 computer have on other FMS system development initiatives?

Mr. Douglas. The IBM 3081 will become the cornerstone of the FMS move from a modest minicomputer environment to a large scale mainframe system which will provide immediate support for a number of major applications. This system is essential to implementing our ongoing extensive systems applications modernization program. A number of major applications are in development and some have had extensive efforts and financial expenditures made toward their implementation.

The forthcoming redesigned Check Payment and Reconciliation (CP&R) system is a major application just nearing completion which has required the expenditure of over $5 million in developmental funds. The present CP&R system has far surpassed its useful life and indeed has been patched and repaired over a period of approximately 30 years. During this time it had been modified and transferred from one computer to another, always at a low cost and always as quickly as possible. The net result of this is that we now have an exceedingly fragile, very difficult and costly to maintain "system" which should have been replaced over twenty years ago. Considering the age of the system and its limitations, a failure could be catastrophic since this system reconciles over $600 billion in

Government checks annually. The replacement for this application has been in development for the past three years and will be ready for the IBM 3081 early in FY 1986.

In addition there are a number of other systems in development including the Governmentwide Accounting system, the Cash Management Information System and the Treasury Receivable Accounting and Collection System. All of these systems and applications are exceedingly important to the Federal Government both in terms of developing and processing high quality financial management information. We are developing systems and applications for the United States directly akin to those financial tools which any well run financial institution would expect to have readily available for its financial well being.

The IBM 3081 will provide a very high level of data processing capability to the FMS. If the computer were not available FMS would be required to lease computer capacity elsewhere at costs far in excess of the cost of acquiring the 3081. Our analyses of the leasing cost situation indicate that in the first year alone the cost of leased computer resources would exceed the cost of acquiring the IBM 3081.

Mr. Abdnor. How certain is FMS that the purchase of the IBM 3081 will meet its computer resource needs for the forseeable future (3-5 years from now)? Is this based on a thorough requirements analysis? Would you submit for the record the following documentation which GSA required to be prepared for the procurement file:

(1) Requirements Analysis
(2) Comparative Cost Analysis
(3) Performance Evaluation
(4) Software Conversion Study

Mr. Douglas. FMS is certain that the IBM 3081 will fill our computer resource needs for the next 2-3 years, and we are satisfied that this machine represents state-of-the-art hardware. Our decision to acquire the IBM 3081 was based on a thorough requirements analysis. This was accomplished partially in house, and partially by contract. After 2-3 years, we anticipate upgrading the IBM 3081 by adding additional front-end hardware for communications and telecommunications. In addition, our future plans call for the supplement, not replacement, of the IBM 3081 with another computer of similar capacity in the next 3-5 years. The IBM 3081 provides a logical growth path in that as requirements grow, a second IBM 3081 can be combined with the first and designated a IBM 3084 which is approximately a 30 MIP machine. The requested documents have been provided to the committees.

Mr. Abdnor. How does FMS intend to finance the remaining portion of this purchase?

Mr. Douglas. We are requesting $4,124,000 for Computer Support for Check Payment and Reconciliation and Other Systems in the FY 1986 budget. Of this total, $2,989,000 is requested to complete the acquisition of the IBM 3081.

Mr. Abdnor. Could you submit for the record what the true savings are to FMS by purchasing this computer earlier than planned?

Mr. Douglas. Acquiring the IBM 3081 in FY 1985 through an interagency agreement when compared with the 24-36 month procurement process, will enable us to avoid costs of at least $12 million.

We are currently developing the redesigned Check Payment and Reconciliation system on Department of Justice (DOJ) computers. Once the system is operational, our timesharing costs with DOJ would have amounted to $6 million annually. By acquiring the IBM 3081, we will avoid these extremely high costs. This cost avoidance is for only one system, the redesigned CP&R system. We expect many more millions of dollars in future savings once the Cash Management Information System, the Central Financial Management System, and other applications are running on the IBM 3081.

Senator Abdnor. The Bureau now has responsibility for commercial Book-Entry services for marketable securities. Would you briefly outline this activity and how the Bureau's review capabilities will be enhanced?

Mr. Gregg. The Federal Reserve Banks, in their capacity as fiscal agents of the United States, establish and maintain book-entry Treasury security accounts for depositary institutions under a system which we call the commercial book-entry system. In this system, the Federal Reserve Banks maintain on their books the primary level of accounts for Treasury securities in the names of various depositary institutions. Those institutions, in turn, record securities in the names of customers, securities dealers, trust departments, etc. Dealers and trust departments, in turn, have records indicating ownership in the names of individuals or institutions. The ownership of securities may be reflected at various levels under the commercial book-entry system, but the ultimate record of Treasury's obligation is at the Federal Reserve Bank level.

The activities of the Federal Reserve Banks in the establishment, maintenance, and transfers of book-entry accounts for Treasury securities are conducted in accordance with Treasury approved procedures. Transactions are reported by the Federal Reserve Banks to the Bureau of the Public Debt which keeps the summary accounts for Treasury securities in book-entry form. Interest and

principal payments are authorized by the Bureau and credited to the respective Federal Reserve Banks when due. The accounting and reporting procedures prescribed by the Bureau are monitored on a continuing basis and accountability is maintained over the amount of Treasury indebtedness in book-entry form, both in total and by Federal Reserve Districts. Effectiveness of the control in this system is reviewed regularly by Bureau specialists, bank management, and the auditors. Should problem areas develop, they are given priority attention in keeping with the Bureau's responsibility for an accurate accounting of the public debt.

Senator Abnor. "Time is Money." It is an adage we have all heard. It is especially appropriate in our discussions today. You have implemented several management initiatives during the past year and plan more in FY 1986. Could you briefly detail these? What will be the income projections?

Mr. Gregg. The Bureau of the Public Debt has several major initiatives identified in its FY 1986 budget which have been planned for over the past several years. The major initiative in the Bureau's Savings Bond Program is the purchase of Optical Character Recognition/Magnetic Ink Character Recognition Equipment (OCR/MICR). We have recently purchased OCR/MICR equipment to process retired savings bonds and are requesting funds in FY 1986 to purchase OCR/MICR equipment to process savings bond issues. The OCR/MICR equipment is a high speed data capture and recording system which will be cost beneficial and eliminate the need for approximately 17 work-years in FY 1987. A savings of 19 work-years has already been achieved from retired bond processing on OCR/MICR equipment. Additionally, the equipment will allow the Bureau to move from an outdated punch card bond to a paper bond.

The Bureau is also requesting $1,682,000 in this budget to replace its mainframe computer. The funds requested in FY 1986 are for the first phase of a five-year project to replace the computer with a new central processor, terminals, and support equipment. The current system, installed in early 1976, uses outdated memory to meet the Bureau's future needs. Further major expansion of the current system would be impractical and costly. The current operating system will not be supported by the vendor after January 1986 and this lack of support underscores the obsolesence of our current processing system. The new computer equipment will enable the Bureau to improve its operational systems. The new equipment will also produce a net cumulative savings over its six-year life cycle, of approximately $4.4 million.

The largest initiative the Bureau is currently undertaking is the establishment of a full book-entry system for marketable securities accounts maintained by Treasury. This system is being developed jointly by the

Bureau and the Federal Reserve and will replace our current registered securities and Treasury bill systems. The new system will enable the Bureau to provide maximum reinvestment opportunities as well as prompt direct service to account holders who will receive payment via an automated payment system. We are estimating that the development of the Book-Entry System will be complete in mid-1986.

The cumulative savings to be achieved through this initiative over a seven-year period from the date of implementation are $67 million. We also expect a reduction of approximately 380 work-years. The Bureau's FY 1986 budget reflects a savings of 42 work-years and $1,922,000 in the marketable securities program.

Senator Abdnor. Funds are being requested to replace the Bureau's Main Frame Computer. It is projected that the new system will have a six year life cycle. We all know there are new innovations in Hi-Tech everyday. Is a six year Life-Cycle cost effective or should we be looking longer term?

Mr. Gregg. The life cycle for the Bureau's new computer system is projected to be six years. This is the most probable time period that the system will be used. Because the technology is changing rapidly, it is likely that the system could become economically obsolete before the end of its anticipated life cycle, if it were longer than 6 years.

Senator Abdnor. We have had some complaints dealing with your Bureau's inability to provide tax information on 1984 Treasury notes as of March 27, 1985. Do you think this is a good precedent to follow? Many calls and letters were sent by the complainants without any results, except the phone calls did produce the excuse that the computers were down and there had been some delay. However, when we expect our citizens to file their taxes by April 15th, it does not seem unreasonable to have our other Treasury agencies provide the necessary information to file these returns in a reasonable period of time. Do you think this was an isolated problem?

Mr. Gregg. Yes, this is an isolated problem. Approximately 837,000 original statements of interest earned were mailed, of which 12,000 were in error. The error did not contribute to any delay in filing returns since the corrected statements contained an explanation of the error and were all mailed by January 31, 1985. The error occurred only on the printed statements mailed to investors. The interest earned and amounts withheld were reported to the IRS correctly.

Every year we receive thousands of inquiries regarding these statements. Most often the problem is that the individual has not received a statement, or received one and subsequently lost or misplaced it.

During the month of March, when we received approproximately 2,500 inquiries, there was a slight delay in response time when our computers were down for a day or two. However, these instances did not cause a prolonged delay in our responding to inquiries. Normally the Bureau responds to inquiries within two weeks. Because of the computer problems and an unusually heavy volume of inquiries as we neared the tax filing deadline, response times averaged between two to four weeks in March. Except for a few unusual or misdirected inquiries, responses are now being made within two weeks.

QUESTIONS SUBMITTED BY SENATOR ROBERT C. BYRD

Senator Byrd. The Parkersburg, West Virginia, facility of the Bureau of the Public Debt maintains operations relating principally to U.S. Savings Bonds. Because of allegedly declining workloads, the staffing level at this facility has been reduced from 963 in fiscal year 1985 to 949 in fiscal year 1986. Would you please provide for the record the statistics and rationale that were used to justify a reduction in staffing at the Parkersburg facility for each of the last several years?

Mr. Gregg. Over the last five years the sale and particularly the redemptions of savings bonds declined significantly from levels reached during the 1970's. For the record I would like to provide a chart which shows the history of the savings bond workload over the last 4 years. Because of this decline and processing efficiencies that the Bureau has been able to achieve in its operations in the Parkersburg facility, the workforce requirement has decreased.

The Savings Bond Operations Office in Parkersburg used a total of 981 average positions in FY 1984. The Bureau's budget for FY 1985 reflects 956 average positions, a reduction of 25. The major portion, or 19 work-years, of the 25 saved in FY 1985 is due to implementation of Optical Character Recognition/Magnetic Ink Character Recognition Equipment (OCR/MICR) to process retired savings bonds. The application of OCR/MICR equipment to process U.S. savings bonds will improve the efficiency of the Bureau's operations by utilizing high speed transport equipment to capture data from retired bonds and concurrent microfilming of those bonds. The remaining FTE reduction from 1984 to 1985 of 6 work-years is due to a variety of smaller management improvements in the Parkersburg facility. The 7 work-year reduction from 1985 to 1986 is due to the reduction in administrative personnel.

Actual Sales and Redemptions
of U. S. Savings Bonds 1981-1984
(Fiscal Years in Thousands of pieces)

	1981	1982	1983	1984
Sales	72,768	64,925	65,082	69,996
Redemp.	140,622	107,243	75,845	69,501

Senator Byrd. In the past, I had been advised that the Treasury Department was looking into the possbility of moving some Washington-based functions to Parkersburg over a period of years to take advantage of existing space and the excellent-quality workforce in Parkersburg. Consequently, last year I recommended that language be included in the Committee report which would accelerate and expendite the review of the relationship between the workforce at Parkersburg and the workforce at Headquarters with a view to shifting functions to the Parkersburg facility to make maximum use of existing space and staff. I have recently been advised, however, that such a shift may be delayed until reductions in force in the Washington area can be absorbed. Nevertheless, I fully intend to continue to pursue this matter. Mr. Gregg, what is your latest estimate of this situation? When can I expect to see a realization of the intent of the Committee report that Washington-based functions be shifted to the Parkersburg facility?

Mr. Gregg. The basic situation has not changed since Assistant Secretary Thompson conveyed the Treasury's position in his December 21, 1984 memorandum to Senator Abnor. As expressed in that letter, the Bureau is currently undertaking a major initiative to move from outdated processes to the use of electronic technologies for processing of Public Debt securities. That initiative is expected to reduce the Washington Office workforce by as many as 380 positions over the next several years. Bureau personnel are currently dedicated to planning, developing and implementing a full book-entry system for marketable securities that will lead to these improvements and savings.

This effort, of course, requires the full attention of senior level staff to assure the proper and efficient implementation of this initiative. It would be inappropriate to carry out an extensive review of the possible shifts of functions to Parkersburg until this initiative is accomplished. Some functions will be phased out over the next several years and other functions will be shifted to the Federal Reserve Banks. However, following completion of this major improvement effort further consideration of the potential for relocating functions at Parkersburg could be undertaken.

Bureau management will continue to evaluate placement of Public Debt functions, so that activities will be accomplished effectively.

SUBCOMMITTEE RECESS

Senator ABDNOR. If there is no further business to come before the subcommittee, we will stand in recess until 2 p.m. on Thursday, March 28, when we will receive testimony from the Executive Office of the President and the Internal Revenue Service. We thank you for being here.

[Whereupon, at 3:25 p.m., Tuesday, March 26, the subcommittee was recessed, to reconvene at 2 p.m., Thursday, March 28.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

THURSDAY, MARCH 28, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:01 p.m., in room SD–116, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, and DeConcini.

EXECUTIVE OFFICE OF THE PRESIDENT

STATEMENT OF JOHN F.W. ROGERS, ASSISTANT TO THE PRESIDENT FOR MANAGEMENT AND ADMINISTRATION; DIRECTOR, OFFICE OF ADMINISTRATION

ACCOMPANIED BY:

CHRISTOPHER HICKS, DEPUTY ASSISTANT TO THE PRESIDENT FOR ADMINISTRATION

URSULA H. PEARSON, DIRECTOR, FINANCIAL MANAGEMENT DIVISION

RONNIE R. RASMUSSEN, BUDGET OFFICER

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order.

We are going to be receiving testimony this afternoon from John Rogers and Christopher Hicks from the Executive Office of the President. And later, Mr. Roscoe Egger, Commissioner of Internal Revenue.

I do not have an opening statement. We will cut it short, and go right into the testimony. We welcome you all here. I know this is Mr. Hicks' first appearance in front of this subcommittee, and I want you to know we are looking forward to working with you, and wish you well in your new position. You have some big shoes to fill there. I have worked with Mr. Rogers all this time.

Today, Mr. Rogers and Mr. Hicks will present testimony for the compensation of the President, the White House Office, the Office of Administration, special assistance to the President, Council of Economic Advisors, Office of Policy Development, and the National Security Council.

And I ask that we go through all the testimony before any questions.

PREPARED STATEMENT FOR THE EXECUTIVE OFFICE OF THE PRESIDENT

Again, I remind you, your entire statement will be put in the record. We are happy to have you proceed in any way you want to.

Mr. ROGERS. Thank you, Mr. Chairman.

I am pleased to be here today to testify on the proposed fiscal year 1986 budget requests for seven accounts of the Executive Office of the President.

With your permission, I will summarize my remarks and present the formal statements for the record.

[The statement follows:]

STATEMENT OF JOHN F.W. ROGERS

Compensation of the President

The Fiscal Year 1986 budget request for Compensation of the President is $250,000. This includes the $200,000 for the direct salary of the President as authorized by 3 U.S.C. 102. This amount has remained constant since 1969. In addition, the President receives a $50,000 expense account for official expenses; any unused portions revert to the Treasury. This expense account is not considered as taxable to the President.

White House Office

The mission of the White House Office (WHO) is to make sure that the best possible support is provided to the President of the United States.

Before you is the Fiscal Year 1986 budget request which totals $24,906,000. This represents a $283,000 decrease or 1 percent below the proposed FY 1985 funding level of $25,189,000. These funds will provide for 322 Full-Time Permanent positions, the same number that are currently authorized.

This reduction reflects the net effect of a combination of factors. The primary ones are reduced personnel costs, the proposed 5 percent pay cut in Federal salaries which becomes effective in January 1986 and the 10 percent administrative overhead cost reduction. Also, printing costs are expected to decrease due to cyclical workload requirements.

Concurrent with this appropriation request, we are asking for the sum of $204,000 for the Fiscal Year 1985 pay supplemental. This represents just half of the total costs associated with this salary increase as we were able to absorb the balance within existing resources.

We have tried to keep this budget request to a minimum. As a result, we have included only those cost estimates that are absolutely essential for the continuation of the White House Office's important functions.

In closing, let me say that I am grateful to the Committee for their past understanding and look forward to continuing support for our future operation.

Office of Administration

The appropriation request of the Office of Administration (OA) will enable the agency to provide common administrative support and services to the White House and the agencies comprising the Executive Office of the President (EOP).

The FY 1986 appropriation request for the OA is $15,597,000; this represents a decrease of $643,000 or 4 percent below the current proposed level of $16,240,000 for FY 1985. This reduction reflects the combination of the proposed 5 percent pay cut in Federal salaries -- effective January 1986 -- and the 10 percent administrative overhead cost cut. By virtue of its mission, OA assumed an administrative cost reduction of $559,000 which is the largest cut within the EOP.

In addition to appropriated funds, we are projecting estimated reimbursements from EOP clients for ADP systems development work in the amount of $2,720,000.

In part, funds will provide for 163 Full-Time Permanent positions; 24 of these are funded by reimbursements. Except for an increase of 2 reimbursable positions to the existing 22, the FY 1985 staffing level remains unchanged.

In addition to our FY 1986 request, we are also seeking funding in the amount of $68,000 for our FY 1985 Pay Supplemental. This represents 50 percent of the total cost associated with this increase.

During the last four years, we have placed increased emphasis on our ADP program. I believe firmly that this investment has yielded greater, overall efficiency and cost savings for the White House and the agencies of the EOP. It is with this spirit that I am pleased to present this FY 1986 reduced request which will ensure a continuation of support to the White House and other EOP agencies without a sacrifice in service.

Special Assistance to the President

The appropriation request for Special Assistance to the President asks for funds to enable the Vice President to provide assistance to the Chief Executive which includes directed and special Presidentially-assigned functions. Additionally, the Vice President through Cabinet membership and White House contact is informed on a continual basis regarding Presidential responsibilities and in the President's absence serves as Chairman of the Cabinet.

In addition to his current Presidential assignments the Vice President also serves as an advisor to the President on matters of national importance, and assists in ceremonial functions and in the conduct of international affairs.

The FY 1986 appropriation request is $1,659,000. This represents a decrease of $17,000 or 1 percent below the proposed level of $1,676,000 for FY 1985. These funds will provide for a staff of 22 Full-Time Permanent positions, the same level as authorized for FY 1985.

This request reflects the net effect of the proposed 5 percent reduction in Federal Salaries beginning in January 1986, the annualized cost of the FY 1985 pay supplemental and the 10 percent reduction in administrative overhead costs.

Concurrent with our 1986 request, we are seeking funding in the amount of $13,000 for the FY 1985 Pay Supplemental. This amount represents 52 percent of the projected costs associated with pay raises which became effective in January 1985.

In closing, this request continues to reflect the Vice President's commitment to uphold the President's efforts and is necessary for him to continue to fulfill these important responsibilities.

Council of Economic Advisers

The Council of Economic Adviser's Fiscal Year 1986 appropriation request will provide the resources needed to comply with the Employment Act of 1946 which mandates the Council's activities. The most important include compiling and analyzing current and future economic developments and reporting these findings to the President. In addition, the Council assists and advises the Chief Executive in preparing the annual Economic Report.

The Fiscal Year 1986 request is $2,301,000 and represents $259,000 less than the existing Fiscal Year 1985 level of

$2,560,000. The major portion of these funds will be used to fund the 33 Full-Time Permanent positions which is a decrease of 5 from the Fiscal Year 1985 authorized level.

The $259,000 decrease was achieved by including the proposed 5 percent reduction in Federal salaries which will become effective in January 1986. Additional economies were realized by the decreased use of commercial timesharing which occurred as a result of purchasing ADP equipment during Fiscal Year 1984. Other minor decreases were achieved in the area of office supplies and equipment and represent the savings associated with the staff reduction.

In summary, this budget request is needed to finance the Council's operations in tne complex and dynamic area of economics and it enables the Council to provide advice to the President which helps him to make important economic decisions.

Office of Policy Development

The Office of Policy Development has primary responsibility for providing advice and assistance to the President on economic and domestic policy matters. The budget requested for Fiscal Year 1986 is for the salaries and expenses necessary to meet these responsibilities.

The Office of Policy Development continues to have responsibility for preparing policy recommendations, administering the cabinet council system, and monitoring and assisting with the implementation of domestic policy matters. Our activities range across many areas: economic affairs, health and human resources, energy, agriculture, natural resources, the environment, commerce and trade, legal policy, management and administration, drug abuse, and other domestic matters. We continue to work closely with the National Security Council staff in areas where domestic policy includes international considerations.

Our Fiscal Year 1986 budget request is $2,726,000. Our budget for the current Fiscal Year of 1985 is $3,020,000 and we are not requesting a supplemental for any part of the 3.5 percent cost of living increase which was effective this past January. The decrease of $294,000 between Fiscal Year 1985 and Fiscal Year 1986 is the net result of a reduced personnel authorization, a 5 percent reduction in individual salaries planned for Fiscal Year 1986, the completion of our automation system, and several minor adjustments.

Direct personnel costs continue to account for more than 75 percent of our total budget. We propose reducing the personnel authorizations by a total of 6 workyears, including 3 Full-Time Permanent positions and 3 temporary positions. This reduction provides a payroll savings of $165,000. The 5 percent reduction in salaries accounts for an added savings of $102,000. The net effect of these savings allows us to absorb the annualized cost of the January 1985 cost of living pay increase and to project a reduction of $203,000 in personnel costs.

During the current Fiscal Year we will complete our computer system, which is integrated into the White House computer system. Thus, our computer system will be fully operational and we should need no major equipment acquisition during Fiscal Year 1986.

I would like to thank the Chairman and members for their continuing support. The budget we have requested is necessary for the operation of our office and would allow us to maintain an active role in providing sound policy advice and assistance to the President.

National Security Council

The National Security Council (NSC) was established by statute after World War II to provide a mechanism for review and decision by the President of policies relating to the national security. The flexible structure of the NSC system allows for coordinated development, presentation and implementation of policy decisions. Faced with the realities of an increasingly complex and ever-changing world situation, this system has proved to be a durable institution.

Today, you are considering a request for $4,627,000 for the expenses of the NSC. This represents an increase of $22,000 over the existing FY 1985 budget authority of $4,605,000. This appropriation would fund the professional staff of 61 Full-Time Permanents that support the NSC. In addition, the appropriation provides for operation of the President's Intelligence Oversight Board and the President's Foreign Intelligence Advisory Board.

No additional funding is being requested for the 3.5 percent cost of living increase which became effective in January 1985.

This FY 1986 budget request will provide the necessary funds for the continued operation of the NSC staff and their vital role in national security.

Biography of John F.W. Rogers

John Rogers was born and raised in the town of Seneca Falls, New York and graduated from high school in 1974. He enrolled in the George Washington University and received his Bachelor of Arts degree in Public Affairs in 1978. He was the recipient of the Trautman Scholarship. While attending the University, Mr. Rogers worked full time in the White House as a research assistant (1974 - 1976). He left the White House in January 1977, and joined the staff of the Senate Republican Policy Committee also as a research assistant. In November 1977, he left the Senate to help launch the magazine, Public Opinion, at the American Enterprise Institute for Public Policy Research (AEI). He worked on the editorial staff of the magazine until he was appointed Special Assistant for Administration and continued in that capacity until he left AEI in November 1980. During the Presidential transition, Mr. Rogers was Executive Assistant to the Director of the White House transition team. He was responsible for reviewing the administrative operations of the White House.

Mr. Rogers joined the White House on January 20, 1981. He was appointed Special Assistant to the President for Administration and Director of the Office of Administration. On February 1, 1982, the President appointed Mr. Rogers, Deputy Assistant to the President for Management. On June 1, 1983, the President appointed Mr. Rogers, Assistant to the President for Management and Administration with overall administrative responsibility for operation within the Executive Office of the President.

On March 13, 1985, the President nominated Mr. Rogers as Assistant Secretary of the Treasury for Management.

Mr. Rogers represents the President on the Board of Trustees of the U. S. Capitol Historical Society, is a member of the Board of Trustees for the National Building Museum, and is a member of the Advisory Council on Historic Preservation. He was awarded the Presidential Citizens Medal by President Reagan on February 12, 1985.

Biography of Christopher Hicks

Christopher Hicks was appointed as the Deputy Assistant to the President for Administration on March 3, 1985. Before this appointment, Mr. Hicks served as the Executive Assistant to the Secretary of the Treasury and as Executive Secretary for the Treasury Department since 1984. He joined the Department in December 1983 as Executive Secretary.

Previously, Mr. Hicks, 34, was the Associate Director (Economic and Transportation Group) of the Office of Presidential Personnel at the White House. From March 1981 to May 1982, he was Associate Counsel in the Office of the Counsel to the President.

Prior to joining the Reagan Administration, Mr. Hicks was a trial attorney with the firm of Fulbright & Jaworski in Houston, Texas. He also served for a year as a law clerk to the Supreme Court of Texas. During the 1980 Presidential campaign, Mr. Hicks was an advanceman for the Reagan/Bush Campaign.

Mr. Hicks received his Bachelor of Arts degree from Colorado College in Colorado Springs, Colorado in 1972 and earned his J.D. from Southern Methodist University in 1977. At SMU, he was an editor of the law review, an officer of the student government and a member of Barristers (an honorary scholastic/service organization).

Mr. Hicks is married to the former Elizabeth Bellamy and they have two sons.

Biography of Ursula H. Pearson

Ursula H. Pearson is the Director for Financial Management for the Executive Office of the President, Office of Administration. She has served in this position since April 1979. She is responsible for Budget, Accounting, Travel, Payroll, and Imprest Fund for the eleven appropriations of the Executive Office of the President.

Mrs. Pearson started her government accounting career in January 1968 with the Department of the Interior, National Park Service. In 1971, she transferred to the Office of Naval Research as an operating accountant. In 1975 she was assigned to the Navy Materiel Support Activity as a Systems Accountant in charge of financial systems development for major Navy accounting systems.

Mrs. Pearson was born on August 31, 1924, in Breslau, Germany. She received her degree in Languages in 1947 from the University of Berlin with a major in English. From 1948 to 1951 she owned a translating and interpreting office in Berlin. In 1951 she came to the U.S. where she was the proprietor of a restaurant in Long Island, New York. She served with the Air Force in a civilian capacity in Wiesbaden, Germany from 1960 to 1966. She attended SW State College in Oklahoma and continued her accounting studies at the University of Virginia. She is a member of the Association of Government Accountants. Mrs. Pearson and her husband, John, live in Alexandria, Virginia.

Biography of Ronnie R. Rasmussen

Ronnie R. Rasmussen is the budget officer for the Office of Administration, Executive Office of the President, and has served in this capacity since August 1981.

Prior to his appointment to this position, Mr. Rasmussen was Deputy Chief of the Financial Management Division with the U.S. Secret Service, an organization in which he has served in varying financial related positions since 1973. Mr. Rasmussen specifically assisted in the automation of their financial accounting system, served as the Staff Assistant to the Assistant Director for Administration and in addition, acted as the Administrative Coordinator for the 1980 Presidential Campaign.

Mr. Rasmussen was born January 19, 1946, and raised in Akron, Ohio. While serving in the U.S. Navy, he was assigned to the White House Communications Agency from 1965 to 1969. He then worked for the National Security Council while attending the American University, where he obtained his Bachelor of Science degree in Accounting in 1973.

Mr. Rasmussen has been a member of the Association of Government Accountants since 1973, and is a recipient of the Presidential Service Badge and Certificate.

Mr. ROGERS. The seven accounts are compensation of the President, White House Office, Office of Administration, special assistance to the President, Council of Economic Advisors, Office of Policy Development, and National Security Council.

With your permission, I will summarize my remarks and provide an overview of these budget requests. I will submit the formal statements for the record.

The total for all of these fiscal year 1986 budget requests is $52,066,000. This represents a $1,474,000 or 2.8-percent decrease from the proposed fiscal year 1985 budget authority of $53,540,000. In large part, these funds will provide for 643 full-time permanent positions needed to staff the various offices. The staffing level has been reduced by 11 positions, 5 in the Council of Economic Advisors and 6 in the Office of Policy Development.

Aside from the staffing reductions, this decrease reflects the combination of two factors. All agencies, with the exception of Presidential compensation, reduced their administrative overhead costs by 10 percent. The Office of Administration took the largest reduction of $559,000 due to the nature of its work which is to provide administrative support to the entire EOP. Excluding the National Security Council, all agencies took the 5-percent pay reduction in Federal salaries, to become effective in January 1986.

Concurrent with the fiscal year 1986 appropriation requests, I am also asking for funding in the amount of $285,000 for the fiscal year 1985 pay supplementals. These pay supplementals are requested for three of the seven agencies, the White House, the Office of Administration, and special assistance to the President. Each has requested only one-half of the costs associated with this salary increase. The remaining accounts were able to absorb the full amount of the pay increase.

In addition to appropriated budget authority, the Office of Administration anticipates $2,720,000 in reimbursements from various EOP users for ADP systems development work. Part of this increased revenue will be used to fund the two additional reimbursable positions in the Office of Administration.

We have succeeded in complying with the two Office of Management and Budget mandated reductions, and have absorbed most of the pay supplemental costs. I believe the budget requests before you are convincing evidence that the Executive Office of the President has achieved cost savings through automation and management efficiencies. I am convinced that the dollars spent on our automation efforts, in particular, have led to greater productivity and efficiency. The return on that investment alone has allowed us to maintain relatively stable personnel and funding levels throughout the last 4 years, while meeting ever increasing demands. We are now supporting the Chief Executive, his staff, and the entire budget process, with the latest equipment and technology.

In conclusion, I would like to offer my sincere thanks to this committee for its past support, and hope to continue this positive association.

That concludes my prepared text.

Senator ABDNOR. The other statement will be put in the record.

I do have a few questions.

ADP UPGRADE

As you are aware, this committee is most interested and supportive of the upgrade of the ADP capabilities in the Executive Office. Much has been accomplished.

Could you just briefly outline where this effort stands today?

Mr. ROGERS. Yes; first of all, I would be remiss if I did not express again our appreciation for the efforts of this committee and the House committee in our automation efforts. We have spent a great deal of money, but I think the investment has been well worth it.

I think you are quite familiar with our plans today, but where do we go from here? The budget request for fiscal 1985 and 1986 provides for the continuation of that upgrading effort. We hope to upgrade the main frame support, our IBM systems, during fiscal 1986. We also hope to increase our disc storage by 30 billion characters.

This year we are going forward with the high speed laser printer, and more emphasis on the connecting and channel equipment to speed up the actual processing.

In the area of executive work stations, last fiscal year we started the effort to bring tailored personal computers to the chief advisors to the President and the Chief of Staff of the White House. That has been successful, and I hope that effort would continue

I think there is no question, from our vantage point, that this is certainly the way of the future, and I hope that we can continue in this cooperative effort.

REIMBURSEMENTS

Senator ABDNOR. The Executive Office receives reimbursement totaling over $2.5 million for ADP systems development work. Who are these users? What type of work does the EOP provide?

Mr. ROGERS. The Office of Administration, according to its charter, provides common administrative support to the entire Executive Office of the President. But in the area of systems development work, we have operated, in the last 4 years, on a reimbursable basis. It is operated this way primarily so each individual agency can make its request to the Office of Administration and also put on the table the dollars they are willing to spend. They can establish their priorities and not waste our time.

Primarily the reimbursements are for systems development work for OMB. I would say close to 60 percent of that $2 million is associated with OMB's ongoing efforts in systems development work, centering on the budget review process and eventually budget management systems.

The remainder is broken up between White House systems development and the other agencies of the EOP which are relatively small users at the moment.

ADMINISTRATIVE AND PAY REDUCTIONS

Senator ABDNOR. The EOP has done an exemplary job in reducing administrative overhead, but I would guess that if the President orders Government to reduce, his Office should certainly set the example.

Your budget projects the 5-percent cost savings for the pay reduction. What impact would the Office feel if the pay cut was not approved, but no funds were provided to cover it? What would you do?

Mr. ROGERS. If we forced agencies not to reduce salaries, but reduce the personnel category, I think there is no question they will have to look to other areas, perhaps taking cuts in overtime, delaying hiring, and allowing attrition to provide those savings.

Some agencies' may have to rely on savings from merit pay plans, cash awards, and things like that. There are various other ways to do it, but they would certainly have an impact.

Senator ABDNOR. I suppose every agency is different?

Mr. ROGERS. It would vary by agency.

Senator ABDNOR. If we did not offer the 5-percent cut, and gave you the dollars, if they are going to continue to pay, they have to let people go, or cut your overtime. That could have serious impacts, could it not?

Mr. ROGERS. I am not sure what the degree of impact would actually be. I still think we could accomplish those reductions within these categories. It would obviously take some effort. Some agencies would have to lag behind on some of their hiring.

Senator ABDNOR. In this committee we have had the discretionary account on the budget for a long time. When they started saying slow down percentage of growth in Government, I think it comes out of my budget in this area, as well as any.

We have had some tremendous reports in our testimony from the various agencies this year, and still cutting back. I am hoping they do not get in too much of a bind. Some of them have cut out a lot of fat. So we will see what happens.

DETAILEES

How many reimbursable positions are assigned to the White House? What is the cost to your budget? How many nonreimbursable detailees are there?

Mr. ROGERS. At the present time we have 38 reimbursable detailees at the White House.

We have budgeted approximately $500,000 for personnel compensation. This is in accordance with the White House Authorization Act, which states that we compensate 180 days after they have been available for our use. For the nonreimbursable category, I think there is somewhere around 100 to 120 personnel at the moment.

These positions belong to other Government agencies who have, over a long period of the history of the White House, had their duty stations assigned there.

For example, the Postal Service has 27 employees that are assigned in the mailroom, who have been there as long as the Office has functioned. Most of the military support are military personnel and they provide coordination with the military network that serves and supports the President and the Executive Office.

FUNDS FOR THE VICE PRESIDENT

Senator ABDNOR. The Vice President is given more responsibilities every day. I have appreciated the efforts of his Office to hold down its requests, but in the past problems have arisen because of shortages at the end of the year.

Will this year's budget adequately meet the needs of the Vice President, or do you think there might be problems?

Mr. ROGERS. Senator, I do not think there is a question in terms of the increased role the Vice President has taken. He has been given additional responsibilities by the President.

It is our feeling that the fiscal 1986 budget is adequate to cover the needs of his office. I assure you, we will not hesitate to come forward if we do not have adequate funding.

PERSONNEL REDUCTIONS

Senator ABDNOR. The Council of Economic Advisors' account projects a sizable reduction in personnel. To what can this action be attributed?

Mr. ROGERS. The Council of Economic Advisors was reduced by five people. In short, that can be attributed as a small victory for the budget officials over the parochial interests of the Council. [Laughter.]

Seriously, I think what happened in that situation was the Chairman, Martin Feldstein, came in during a transitional period when he did not have the flexibility to hire people because prior commitments had been made to academic institutions.

We granted him an increase. He is now gone. It was my feeling that those positions were no longer necessary, and I pressed so we could take the reductions there. They agreed. I suppose when the new Chairman is appointed he may see the need to request an increase.

It is my firm belief that they are not necessary, and they can effectively operate at that same level.

Senator ABDNOR. We will follow that with a great deal of interest, to see who is right on that. Or who wins out might be a better word.

The Office of Policy Development is also reducing its personnel. Could you explain this reduction?

Mr. ROGERS. In that particular case, they continually maintained low levels, and I felt they could take the cut. I pushed for these reductions, as you may be aware, in these last 4 years.

INCREASED FUNDING FOR THE NATIONAL SECURITY COUNCIL

Senator ABDNOR. Well, you are making progress.

I am a bit concerned as I look at the National Security Council numbers. I do not want to belittle its importance, but every office in the EOP is important to the President.

What I am leading up to is the fact that the NSC has requested sizable increases in travel and communications, while the other offices have not.

Could you address this part of the request?

Mr. ROGERS. In the case of NSC, they appealed those reductions. The Executive Secretary of NSC felt it necessary because of the nature of their operation. It is a little unfair to say they did not take any reductions. They reduced personnel compensation by approximately $47,000.

They have made other efforts to reduce their other services category. They went up in rent and utilities because of an increase in cost of utilities. This includes FTS telephone charges which are billed on a reimbursable basis by GSA.

In the area of travel, it was the result of a policy change which requires sending certain national security officers on Presidential, Vice Presidential, and certain select Cabinet missions abroad to provide better coordination. That is what is reflected in those two entries.

In fairness, I should also point out that when I last appeared I rescinded the request for a pay supplemental for them last year and they have no pay supplemental in fiscal 1985.

Senator ABDNOR. That is the one?

Mr. ROGERS. That is the $22,000 net increase.

Senator ABDNOR. The salary decrease of 5 percent was not?

Mr. ROGERS. No; they made a cut of $7,000 in full-time and $37,000 in special personnel services.

Senator ABDNOR. We have been joined by my colleague, Senator Mattingly. I have been monopolizing the time.

Do you have any opening statement?

Senator MATTINGLY. Keep right on. I enjoy listening to you.

Senator ABDNOR. Oh, I am sure you do.

PREPARED STATEMENT FOR OFFICIAL RESIDENCE OF THE VICE PRESIDENT

The Department of the Navy is responsible for the budget of the official residence of the Vice President. I ask unanimous consent that a statement by Capt. Giles R. Norrington, Assistant Director of Budget and Reports, Department of the Navy, outlining the fiscal 1986 request, be placed in the record at this point.

[The statement follows:]

STATEMENT OF CAPT. GILES R. NORRINGTON, ASSISTANT DIRECTOR, BUDGET AND REPORTS, DEPARTMENT OF THE NAVY

Mr. Chairman and members of the committee, it is my pleasure to appear before this committee to present the Department of the Navy's fiscal year 1986 budget request for the appropriation, official residence of the Vice President.

The request for fiscal year 1986 is $204,000, which is $15,000 less than was reflected in the request for fiscal year 1985. The incremental change from fiscal year 1985 is composed of an increase of $38,000 for continuing the repair and replastering of interior walls and the upgrade of associated electrical wiring, an increase of $4,300 for increased costs of utilities and other services, and a decrease of $57,300 associated with one-time efforts in fiscal year 1985. The largest component of these cost changes, $38,000 for continuing the repair, rewiring, and replastering of interior walls, reflects a conscious decision to phase the work over an extended period. We could have completed the job in several months, but only at the cost of considerable inconvenience and disruption while the residence was effectively uninhabitable.

Details of our budget request by function are furnished in table 1.

TABLE 1.—FUNCTIONAL AREAS

	Fiscal year—		
	1984 actual	1985 estimate	1986 estimate
Utilities	$29,000	$30,400	$31,700
Other services:			
Maintenance of residence	28,200	29,600	30,800
Rehabilitation and alterations	11,000	11,500	12,000
Supplies	6,600	6,900	7,200
Furnishings	6,500	6,800	7,100
Vehicle lease	2,400	2,500	2,600
General administration	6,000	6,300	6,600
Services	4,700	4,900	5,100
Equipment maintenance	2,600	2,800	2,900
Official entertainment	60,000	60,000	60,000
Replaster/repair interior walls, upgrade associated wiring	105,000	.....	38,000
Repair/replace boiler and steam system	.....	12,000	.....
Replace metal garage roof	.....	12,000	.....
Replace basement floor tile	.....	9,300	.....
Install sewer manhole	.....	4,000	.....
Conduct comprehensive engineering study	.....	20,000	.....
Total	262,000	219,000	204,000

CLOSING REMARKS

Senator ABDNOR. If no other questions, we thank you gentlemen and lady for appearing today, and for the fine testimony. We are looking forward to working with you.

Mr. ROGERS. Thank you, Senator.

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

STATEMENT OF ROSCOE L. EGGER, JR., COMMISSIONER

ACCOMPANIED BY:

JAMES I. OWENS, DEPUTY COMMISSIONER
FRED T. GOLDBERG, JR., CHIEF COUNSEL
VERNON J. OWENS, DEPUTY CHIEF COUNSEL
PHILIP E. COATES, ASSOCIATE COMMISSIONER, OPERATIONS
M. EDDIE HEIRONIMUS, ASSOCIATE COMMISSIONER, DATA PROCESSING
NORMAN A. BOLZ, ASSOCIATE COMMISSIONER, POLICY AND MANAGEMENT
STEPHEN E. TAYLOR, DIRECTOR, FINANCE DIVISION
GARY KOWALCZYK, ACTING DIRECTOR, OFFICE OF PLANNING, BUDGET, AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

PREPARED STATEMENT

Senator ABDNOR. Our next witness will be Mr. Roscoe Egger, Commissioner of the Internal Revenue Service. Good to have you again with us.

I guess you timed that pretty well. We are moving right along here today. We will not tie you up too long, because I know you have a lot of places to be.

Introduce your colleagues, and proceed in any manner you wish.

Your entire statement will be made a part of the record.

Mr. EGGER. Let me ask that the full statement be in the record, and we will try to summarize the points here.

Senator ABDNOR. Fine.

[The statement follows:]

STATEMENT OF ROSCOE L. EGGER, JR.

Mr. Chairman and members of the Committee, I am pleased to be here today to present the proposed budget for fiscal year 1986 for the Internal Revenue Service. First, I would like to introduce my associates: Deputy Commissioner Jim Owens; Fred Goldberg, Chief Counsel; Jean Owens, Deputy Chief Counsel, Associate Commissioner Phil Coates for Operations; Associate Commissioner Ed Heironimus for Data Processing; Associate Commissioner Norm Bolz for Policy and Management; and our Finance Division Director, Steve Taylor. Also with us today representing the Treasury Department is Gary Kowalczyk, Acting Director of the Department's Office of Planning, Budget and Program Analysis. Several of our witnesses are appearing for the first time. With your permission, I will submit their biographical statements for the record.

FY 1985

Mr. Chairman, we are proposing several adjustments to the FY 1985 Continuing Resolution approved by the Congress. To help fund the additional cost associated with the 3.5 percent pay raise which went into effect in January, 1985 we are requesting $32.2 million. Also, $2.4 million and 42 positions are requested for the President's task forces on organized crime and drug enforcement to finance expansion of the task force effort to the thirteenth city, Miami, Florida. And, $9.0 million is requested as a one-time increase in the capitalization of the Federal Tax Lien Revolving Fund which is used to finance the redemption of real property. This amount was authorized in the Deficit Reduction Act of 1984.

We are also proposing a rescission of $4.2 million to implement Section 2901 of the Deficit Reduction Act of 1984 which called for Government-wide spending reductions in motor vehicles, travel, public affairs, printing and consultant services.

Summary

Mr. Chairman, in keeping with the Administration's goal of limiting the federal budget by freezing spending in fiscal year 1986, the budget for the Internal Revenue Service provides for average employment of 86,489 and some $3.5 billion to administer the nation's tax laws. This is a decrease of 1,254 average positions and $30.4 million from the revised level for fiscal year 1985.

Our fiscal year 1986 budget has five major goals:

1) to maintain essential levels of tax administration;

2) to continue efforts begun over the last few years to modernize ADP systems;

3) to implement the Deficit Reduction Act of 1984;

4) to begin to hire revenue agents for the expansion of examination efforts in FY 1987-1989; and

5) to achieve necessary reductions and meet uncontrollable cost and workload increases.

Maintaining Tax Administration

Our first goal is to maintain essential levels of tax administration. This includes providing basic funding to continue participation in the President's Task Forces on Organized Crime and Drug Enforcement. The Service's resource commitment to this effort is the largest of any Treasury bureau. During FY 1984, the Service's participation in the task forces resulted in the initiation of 618 investigations, 448 prosecution recommendations and 177 convictions. In FY 1986, we will also process 5.7 million additional tax returns and supplemental documents, and provide timely tax law and account assistance to over 55 million taxpayers through direct assistance or taxpayer education.

ADP Modernization

A second major goal of this budget is to continue ADP modernization projects initiated in prior years such as optical character recognition, automated collection system and automated examination system.

Deficit Reduction Act

A third initiative in our budget is to perform essential new work relating to the Deficit Reduction Act of 1984, which added or changed many tax provisions. The Service will devote time and resources to issuing regulations and rulings, updating tax forms and instructions, following through on tax shelter registrations, and matching of mortgage interest payments.

Revenue Initiative

A fourth major goal is to advance hire, late in the year, as many revenue agents as possible, that are planned for a major revenue initiative that begins in fiscal year 1987. This initiative will increase revenue by an estimated $4.6 billion over the three year period by adding 2,500 average positions each year to the examination of tax returns.

Budget Reductions

Our fifth goal, achieving reductions while still meeting unavoidable cost and workload increases, produces some $240 million in savings and reductions. Efforts contributing to this reduction include cutting administrative staff by ten percent, streamlining overhead and program support, achieving productivity savings from efficiencies in processing tax returns and from investments in ADP and systems modernization, reducing employee pay rates by five percent, and scaling down programs and staff in most activities by three percent. No program reductions will be applied to the examination or document matching programs.

SALARIES AND EXPENSES

Executive Direction

The Executive Direction function includes my office, the Chief Counsel's office, the three Associate Commissioners, and the Assistant Commissioner (Inspection). Included in my office are the Equal Employment Officer, the Taxpayer Ombudsman, the Assistants to the Commissioner for Public Affairs and Legislative Liaison, and their immediate staffs.

The budget for Executive Direction totals 127 average positions and $8.4 million, a net decrease of one average position and an increase of $12,000 for mandatory costs.

Management Services

The Management Services activity develops and provides Servicewide policy for managing the human, logistical and financial resources needed to fulfill the Service's tax administration mission in a cost effective manner. Specifically, Management Services is divided into the three following areas, each responsible for specialized support programs: Human Resources; Planning, Finance and Research; and Support and Services.

The FY 1986 Management Services request totals 1,944 average positions and $87.5 million, a decrease of 135 average positions and $10.1 million below the revised level for FY 1985. This reduction reflects savings from reducing administrative services, streamlining overhead support and productivity.

For FY 1986, we are requesting that not to exceed $500,000 remain available until expended in the Salaries and Expenses Appropriation for research. These no-year funds are important to allow completion of research projects which analyze the specific nature of particular tax gap components, address areas that represent new or potential areas of noncompliance, and identify factors affecting compliance.

PROCESSING TAX RETURNS

Returns Processing and Revenue Accounting

This activity provides for processing tax returns, issuing refunds and notices of tax due, accounting for revenues, and processing information returns for document matching.

The resources requested for Returns Processing and Revenue Accounting total 21,336 average positions and $760.9 million, a decrease of 239 average positions and $18.9 million from FY 1985. With the resources requested, we will receive and process almost 179 million tax returns and issue over 81 million refunds to individual taxpayers.

The resources requested include 705 average positions and $14.6 million to process almost 5 million additional tax returns and related schedules and some 752,000 additional supplemental documents, and to issue notices, tax bills and refunds promptly. This increase in staffing is being more than offset by saving 362 average positions and $8.9 million due to anticipated employee productivity and procedural efficiencies; reducing 424 average positions and $28.7 million by scaling down selected programs; and cutting 168 average positions and $5.3 million in administrative and overhead personnel which support processing tax returns.

An integral part of our returns processing system is to math verify the tax returns filed. This yielded a net $2.2 billion in FY 1984.

Computer Services

The Computer Services activity provides comprehensive developmental data processing support for the Service, including the development, acquisition, installation, and evaluation of computer systems for tax administration. The request totals 1,510 average positions and $237.4 million, a decrease of 26 average positions and an increase of $30.7 million over FY 1985.

The reduction in staffing reflects efforts underway to reduce administrative services and streamline support by 37 average positions and $1.7 million. This reduction is offset by an increase, including 46 average positions due to annualization of ADP equipment and normal contract cost increases.

For FY 1986, we are requesting that not to exceed $35.0 million remain available until expended for systems modernization initiatives in the Processing Tax Returns Appropriation. The purpose of this authority is to allow for the lengthy procurement process, site preparation and other unanticipated delays in acquisition of services, equipment and supplies to support approved ADP and systems modernization initiatives.

EXAMINATION AND APPEALS

Examination

I would like now to comment briefly on our Examination program. Examination of returns is one of the primary means through which full compliance is encouraged, errors corrected and public confidence in fair tax administration maintained.

Requested resources for the Examination program in FY 1986 total 29,518 average positions and $1,126.6 million, a net increase of 322 average positions and $1.1 million above the level for FY 1985.

At the requested program level, we plan to audit about 1.4 million returns in district offices and service centers and to make 1.3 million service center contacts and W-4 program contacts in FY 1986, including follow-up on underreporting of income disclosed by matching information returns filings with taxpayers' returns.

We estimate that the additional tax, penalties and interest assessed from these efforts will be $14.7 billion, $0.3 billion over that estimated for FY 1985.

This request for Examination includes an additional 290 average positions and $10 million which supplements resources redirected this year from other work to implement the Deficit Reduction Act of 1984 (P.L. 98-369). These resources are needed to assure compliance with the tax shelter, cash received in a trade or business, foreign and general provisions of the Act.

In addition, 263 average positions are being transferred to Examination from the Returns Processing and Revenue Accounting activity to complete followup workload on 5.5 million under-reporter document matching cases initiated in late FY 1985 for 1983 tax returns.

The Administration has included a major revenue initiative in the President's budget message for fiscal years 1987-1989. This initiative, which is also endorsed by the President's Private Sector Survey on Cost Control (Grace Commission), will increase revenue by $4.6 billion over the three year period by adding 2,500 average positions each year to the examination of tax returns. Within the total budget request, the Service will begin to hire revenue agents late in FY 1986 to ensure selection of better qualified applicants and allow for initial training, thus improving their productivity in subsequent years.

Appeals and Tax Litigation

The Appeals program offers taxpayers an independent administrative review of contested tax assessments proposed by the Examination activity of certain penalties assessed by service centers and the Collection program, and of certain determinations made by the Employee Plans and Exempt Organizations programs. It provides taxpayers an opportunity to resolve disputes with the least possible delay and encourages compliance by maintaining public confidence in the Service's ability to administer the tax laws fairly and impartially.

The Tax Litigation function represents the Service in judicial proceedings that cannot be resolved through administrative appeals.

A total of 3,537 average positions and $155.4 million is requested in FY 1986 for Appeals and Tax Litigation, a decrease of 16 average positions and $0.3 million below the FY 1985 level.

With the resources requested for Appeals, 1,000 additional taxpayer disputes are expected to be disposed.

In Tax Litigation, the requested level will allow for 38,188 Tax Court and refund case closures. Ending inventory will increase by 17,400 cases as a result of litigation against abusive tax shelters.

Employee Plans and Exempt Organizations

The Employee Plans function ensures voluntary compliance with those provisions of the Internal Revenue Code applicable to employee pension plans. Likewise, the Exempt Organizations function monitors organizations exempt from federal income tax to ensure their compliance with statutory requirements.

A total of 2,481 average positions and $93.3 million is requested in FY 1986 for Employee Plans and Exempt Organizations, a decrease of 21 average positions and $2.3 million below FY 1985.

During FY 1986, resources will primarily be devoted to handling the substantial volume of determination letter applications that are expected to result from the passage of the Tax Equity and Fiscal Responsibility Act of 1982, the Retirement Equity Act of 1984 and the Deficit Reduction Act of 1984.

In the Exempt Organizations area, the requested resources provide staff to issue prompt responses to approximately 74,300 requests from organizations seeking tax-exempt status and appropriate advance assurance of deductibility.

INVESTIGATION, COLLECTION AND TAXPAYER SERVICE

Tax Fraud Investigations

The Tax Fraud Investigations activity is repsonsible for investigating criminal violations of the Internal Revenue laws. The resources for this activity in FY 1986 total 4,413 average positions and $209.4 million, a decrease of 74 average positions and $4.4 million below the FY 1985 level.

A greater emphasis is being placed on the growing amount of activity involving illegal tax protesters, fraudulent tax shelters, questionable refund schemes, offshore banking, and tax havens. The Service will continue to commit a substantial level of resources to the special enforcement areas of organized crime and narcotics trafficking. In addition, the Service will maintain its commitment of resources to the President's Task Forces on Organized Crime and Drug Enforcement. In FY 1986, 262 average positions and $12.3 million are budgeted for this effort.

Collection

The Collection activity has the responsibility to collect unpaid accounts; secure delinquent returns; determine and analyze why accounts become delinquent; develop and implement programs to prevent accounts from becoming delinquent and prevent nonfiling; determine and analyze the reasons for nonfiling; and measure the types and degrees of nonfiling.

The proposed budget for Collection totals 16,056 average positions and $602.4 million in FY 1986, a decrease of 881 average positions and $21.2 million below the FY 1985 level.

In the Accounts Receivable Program, the Service will complete action on some 3.3 million unpaid accounts and collect revenue of $9.5 billion, an increase of $280 million over FY 1985. In addition, the Service will collect revenues of $7.8 billion from initial billing on unpaid accounts. The Delinquent Returns Investigations Program identifies taxpayers who have not complied with their filing requirements. The requested resources will enable the Service to secure 3.1 million delinquent returns and assess $4.5 billion in unreported tax.

The Service successfully completed nationwide implementation in FY 1984 of the Automated Collection System (ACS) which provides state-of-the-art computer and telephone technology in order to improve office operations and to accelerate collections of unpaid

taxes. The system is the initial step in a series of efforts to control increasing workload through improved productivity. During FY 1985 and FY 1986, the Service will make major strides toward automating the remaining Collection activities including the Collection field and special procedures functions. Savings of 262 average positions and $2.6 million from automation of these functions are reflected in the FY 1986 budget.

Taxpayer Service

The Taxpayer Service activity promotes voluntary compliance with Federal tax laws on the part of all taxpayers by informing them of their responsibilities and by providing service which will assist them in meeting their obligations. This activity also provides information about Service notices and procedures and resolves inquiries concerning taxpayers' accounts.

Resources requested for FY 1985 total 4,214 average positions and $164.3 million, a decrease of 156 average positions and an increase of $8.1 million. The FY 1986 program provides a balanced and cost effective system for providing essential tax information to the public. Over 55 million taxpayers will be served through direct assistance or taxpayer education.

Timely tax law and account assistance through the toll-free telephone program, walk-in's and correspondence will continue to be provided in FY 1986. Additionally, the Outreach program will provide tax law information and group tax return preparation assistance at community and business locations. The use of computer controlled multifunctional equipment providing both tax law information and refund information will also be continued in FY 1986.

The Tax Counseling for the Elderly program will be fully funded at the FY 1985 level of $2.0 million for grants to participating organizations.

Enforcement Litigation and Rulings

Enforcement Litigation provides legal advice and assistance to field Collection and Tax Fraud Investigations. Support is also provided through legal services in the administrative areas of labor relations, contracting, tort claims, equal employment opportunity, disciplinary matters, disclosure matters under the Freedom of Information Act and the Privacy Act, and tax practitioner discipline.

The Rulings program accomplishes a variety of legal and technical functions which facilitate taxpayer compliance by promoting the uniform interpretation and application of the Federal tax laws.

The requested resources of 1,433 average positions and $65.6 million in FY 1986 represent a decrease of 107 average positions and $5.3 million below the FY 1985 level.

Summary

In conclusion, I would like to emphasize that this budget request follows the Administation's goal of freezing spending in fiscal year 1986 to limit the federal budget. Within this objective, we will achieve necessary reductions and cover unavoidable cost and workload increases, implement the Deficit Reduction Act of 1984, continue efforts begun over the last few years to modernize ADP systems, maintain essential levels of tax administration, and begin a major revenue initiative planned for fiscal years 1987-1989 by advance hiring revenue agents late in FY 1986 to the extent possible.

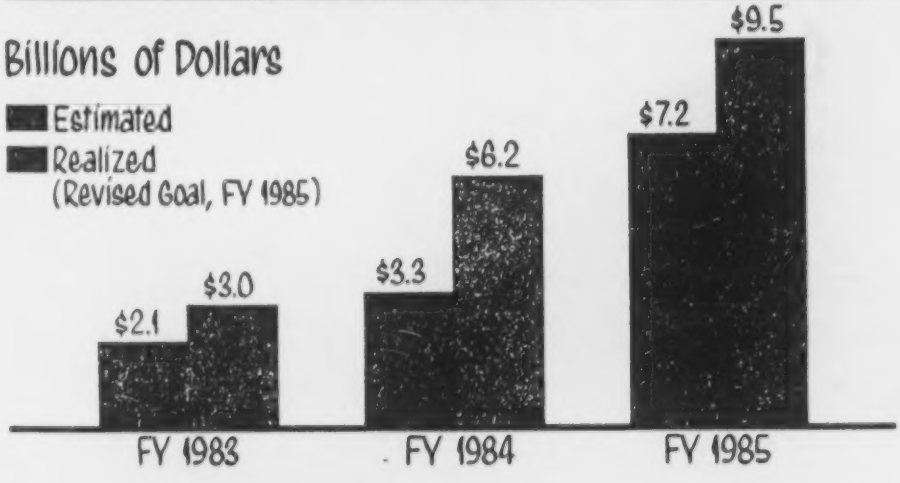
Because of the uncertainties involved in estimating the impact of program reductions, the Internal Revenue Service is requesting authority to transfer funds, between appropriations, by up to five percent. In addition, special transfer authority (five percent or $15 million) is again being requested to optimize resources used to

match wages, interest and dividends and identify and collect taxes due from unreported income and nonfiling under the Information Returns Program.

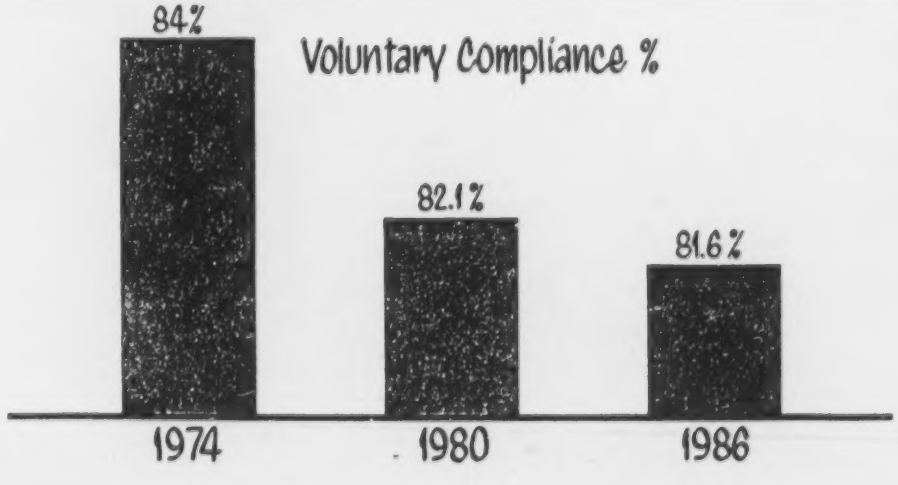
Also, $25,000 is requested for official reception and representation expenses. These funds cover expenses incurred, for purposes of protocol, to socially entertain high level foreign officials during their visitations to the IRS, or when the IRS hosts the Inter American Center of Tax Administrators (CIAT) or middle management tax seminars (INTAX).

Mr. Chairman, my colleagues and I will be pleased to try and answer any questions you or the members of the Subcommittee may have.

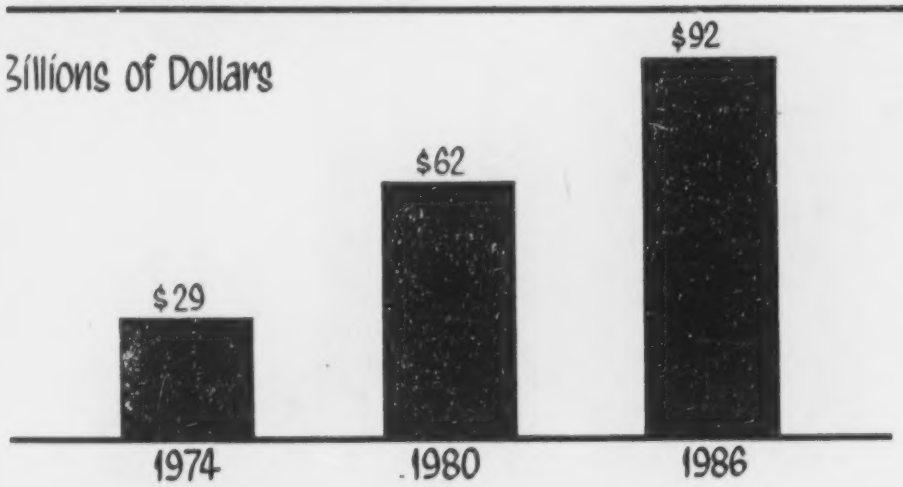
FY 1983 Revenue Initiative
Cumulative Revenue Collections



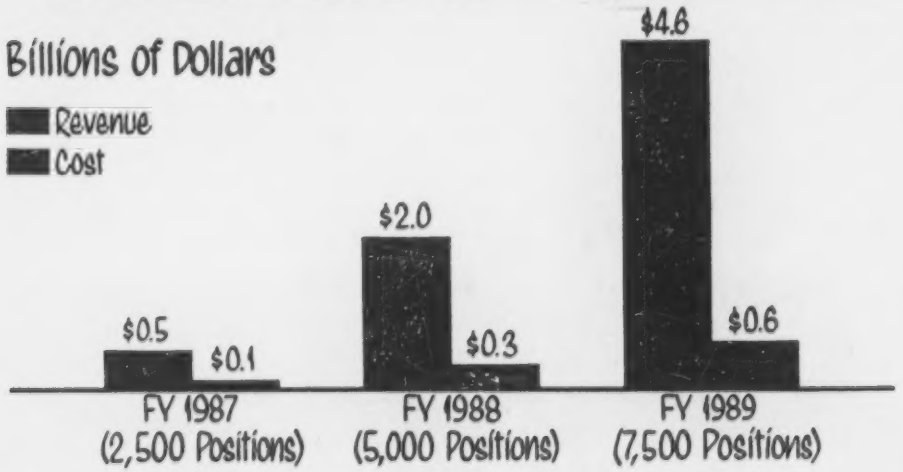
Income Tax Compliance
FY 1974 - FY 1986

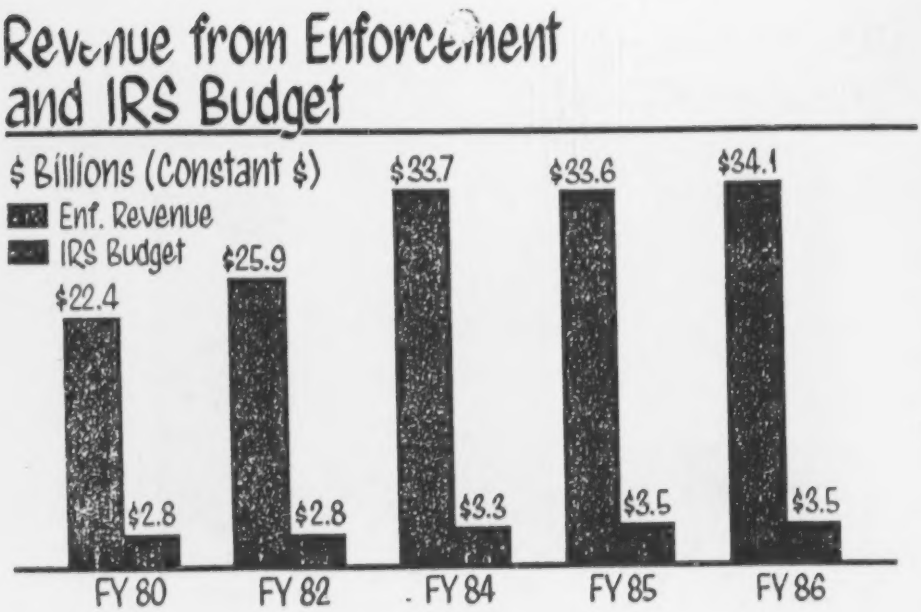


Total Income Tax Gap
Fiscal Years 1974-1986



FY 1987-89 Revenue Initiative
Cumulative Revenue and Cost





Biography of Stephen E. Taylor

Stephen E. Taylor was selected as Director, Finance Division on February 25, 1985. In this position, he serves as principal advisor to IRS executives in developing the budget, managing appropriated funds and accounting for their use.

Taylor began his IRS career in 1966 as an Administrative Intern. He held increasingly responsible positions in IRS financial management and served as Chief, Budget Branch from 1976-1982. He became the Assistant Fiscal Management Officer in 1982.

A native of Utah, Taylor holds a bachelor's degree in Political Science from Utah State University at Logan and attended graduate school at the University of Utah at Salt Lake City.

Taylor is married to Barbara Jackson, formerly of Salt Lake City; they have two children.

Biography of Fred T. Goldberg, Jr.

Fred T. Goldberg, Jr. was appointed to the position of Chief Counsel for the Internal Revenue Service on March 15, 1984. As Chief Counsel for the Internal Revenue Service, Mr. Goldberg is also Assistant General Counsel of the Treasury Department.

Before his appointment, Goldberg was a partner in the Washington, D.C. office of the law firm of Latham & Watkins, Los Angeles, California. During 1981-1982, Goldberg served as Assistant to Commissioner Egger and as Acting Director of the Legislation and Regulations Division of the Office of the Chief Counsel. During 1971-1973, he served as instructor in political science

and economics at Yale College and as Assistant Dean, Calhoun College, Yale University.

A native of St. Louis, Missouri, Goldberg holds a bachelor's degree in Economics from Yale University and a law degree from Yale University Law School. He is a member of the State Bar of California and has been active in the Tax Section of the American Bar Association.

Goldberg is married and has four children.

Biography of Vernon Jean Owens

Vernon Jean Owens was appointed to the position of Deputy Chief Counsel for the Internal Revenue Service on April 25, 1984. In this position, he is the highest ranking career lawyer in the Internal Revenue Service. He assists the Chief Counsel in developing policies regarding tax litigation, interpretation, and development of internal revenue laws and all nontax legal matters for IRS. He advises the Chief Counsel and directs administrative and management programs for the Office of the Chief Counsel.

Owens began his IRS career in 1965 in Jacksonville, Florida where he served as Staff Assistant and Assistant Regional Counsel for the IRS Southeast Region. He became the Regional Counsel for the IRS Central Region in 1979.

A native of Pike County, Indiana, Owens holds a bachelor's degree in Economics from the University of Evansville and a law degree from the Indiana University School of Law in Bloomington, Indiana. He is a member of the state bars of Indiana and Florida.

Owens is married and has two children.

INTRODUCTION OF ASSOCIATES

Mr. EGGER. First off, let me introduce the folks here with me.

James Owens, the Deputy Commissioner; Fred Goldberg, Chief Counsel; Steve Taylor, Director, Finance Division. This is Steve Taylor's first appearance in this capacity.

Senator ABDNOR. Contrary to what Mr. Egger told you, we are really not hard to get along with.

Mr. TAYLOR. Glad to hear that, Senator. [Laughter.]

Mr. EGGER. Also, we have Mr. Vernon Owens, Deputy Chief Counsel; Philip Coates, Associate Commissioner; Norman Bolz, Associate Commissioner; and Ed Heironimus, Associate Commissioner. Also with us is Gary Kowalczyk, Acting Director of the Office of Planning, Budget, and Program Analysis, Department of the Treasury.

FISCAL YEAR 1985 CONTINUING RESOLUTION

Mr. Chairman, we would like to propose several adjustments. First, to the fiscal 1985 continuing resolution, which has already been approved by the Congress, in order to help fund the additional costs associated with the 3½-percent pay raise, which went into effect in January of this year.

In that connection, we are asking for $32.2 million, which represents 50 percent of that increase. Also, $2.4 million and 42 positions are requested for the President's task forces on organized crime and drug enforcement, to finance the expansion of the task force effort to cover the 13th task force located in Miami.

Senator ABDNOR. Thirteen?

Mr. EGGER. Thirteen task forces.

Senator ABDNOR. Spread out all over?

Mr. EGGER. They are all over the country.

Senator ABDNOR. This is not the first one, though?

Mr. EGGER. No; there was, and remains, a task force in south Florida. Since then, at the President's request, 12 task forces have been organized around the country, on a regional basis. These are coordinated by the U.S. attorneys.

Senator ABDNOR. $2.4 million of this supplemental pretty well goes in this area?

Mr. EGGER. That goes solely into the 13th task force.

Nine million dollars is requested, as a one-time increase, in order to capitalize a Federal tax lien revolving fund, to finance real property. This amount was also authorized in the Deficit Reduction Act of 1984.

We are also proposing an adjustment called a rescission, $4.2 million, of the fiscal year 1985 budget to implement section 2901 of the Deficit Reduction Act, which called for Governmentwide spending reductions in motor vehicles, travel, public affairs, printing, and consulting services.

Senator ABDNOR. This is Senator DeConcini.

I am just going to take 5 minutes, to get to that other committee meeting, and I will come right back.

I have read your statement. You keep right on going.
Mr. EGGER. Good.

GENERAL DIRECTION

I want to emphasize five of our major goals this year. First, the essential levels of tax administration. Next, to continue the efforts which we started some few years back to modernize our data processing system.

Third, to implement the Deficit Reduction Act of 1984. Next, to start hiring, toward the end of the fiscal year, revenue agents. This would be in order to get a running start on the expansion of examination efforts in fiscal years 1987 through 1989.

Finally, to achieve the necessary reductions and meet uncontrollable costs and workload increases.

MAINTENANCE OF TAX ADMINISTRATION

Our first goal is to maintain essential levels of tax administration. This is providing the basic funding to continue the participation in the President's task forces on organized crime and drug enforcement.

The Service's resource commitment to this effort, by the way, is the largest of any Treasury bureau. During fiscal year 1984, our participation in the task force has resulted in the initiation of 618 investigations, 440 prosecution recommendations, and 177 convictions.

In fiscal year 1986, we will also process 5.7 million additional tax returns and supplemental documents, and provide timely tax law, and account assistance to over 55 million taxpayers, through direct assistance, or taxpayer education.

ADP AND SYSTEMS MODERNIZATION

A second initiative in our budget is to continue the data processing modernization. This was initiated in the last several years and includes such projects as optical character recognition, automated collection system, and the startup of our automated examining.

DEFICIT REDUCTION ACT OF 1984

Third, our goal is to perform the essential new work relating to the Deficit Reduction Act of 1984, which added, or changed tax provisions. We will devote considerable time and resources to the issuance of regulations and rulings, updating tax forms and instructions, following through on tax shelter registrations, and the matching of such things as mortgage interest payments.

REVENUE INITIATIVE

The fourth objective is to advance hire, late in the year, as many revenue agents as possible in order to plan for the major revenue initiative to begin in fiscal year 1987. This will increase revenue by an estimated $4.6 billion over a 3-year period by adding 2,500 new positions each year in the examination of tax returns.

STAFFING REDUCTIONS

Our fifth major goal is to achieve reductions while still meeting unavoidable cost and workload increases. This will produce $240 million in savings. Efforts include cutting administrative staff by 10 percent, streamlining overhead, and so on.

Details of the program plans and the related resource needs by appropriation and budget activity have been provided in the detailed budget justifications as well as in my complete prepared statement. I would now like to present a few charts, and then we will be happy to answer whatever questions we can.

1983 REVENUE INITIATIVE

I think these charts may be of interest to the committee. The first chart shows what we did with the revenue initiative in 1983. You may recall that in 1982, it was with respect to the fiscal year 1983 ensuing budget that the Congress approved a revenue initiative which included the addition of some 5,225 positions. At that time we anticipated that in each of the fiscal years we would produce, as a result thereof, the dollars of revenue in billions that are shown in the orange bars there. In this case, the expectation by the end of fiscal year 1985 would be $7.2 billion. In fact, we have produced $9.5 billion as a direct result of the increase in staffing which took place beginning in fiscal year 1983. In other words, Mr. Chairman, had we not gone into that in 1983 and the ensuing years, we would, at the present time, be some $9.5 billion shorter than we are now.

Senator DECONCINI. How much was spent to get that extra realized revenue? How much did that cost?

Mr. EGGER. About $600 million, I believe.

Senator DECONCINI. Is it fair to assume another $600 million would give you an equal amount of increase?

Mr. EGGER. We cannot repeat all that again. I will come back to what we are proposing in fiscal years 1987 to 1989.

The reason is that the two things present in 1983 are not present now. No. 1 is that we were able to achieve a much greater return on our investment, if you will, in the collection area. That has since tended to flatten out to some extent.

The other one is that we redirected a lot of our efforts into extremely productive corporate and individual tax return examinations. While that continues to be a productive use of our resources, we have already made that first shift. So a part of this $9.5 billion is due to that, which is a one-time thing.

Senator DECONCINI. Last year, Mr. Egger of the IRS requested 1,447 average positions and $52.1 million to contain the tax gap of $80 billion. I am told that the agency focused compliance efforts in areas of underreporting and tax avoidance. Included in this effort were such things as exams of nonfarm individual businesses as major sources of unreported income, slowing the growth of appeals and tax litigation, and increasing the collection of unpaid tax.

The tables show that the tax gap was increased $92 billion. Is this an indication that our tax gap initiative has been a failure or that the tax gap has just outgrown the reliability of control or both?

Mr. EGGER. In fact, we did exactly what we proposed to do, which is redirect our resources into more complex returns, and the results on an exam-by-exam basis show it. In other words, the dollar amounts collected from each examination are continuing to go up as a result of more appropriately targeted resources.

The difficulty is that the number of people that we have in the field for fiscal year 1986 is going to be less than we had in fiscal year 1980. The audit coverage now is dropping from somewhere around 2 percent in 1979 to about 1.2 percent in 1986.

Senator DECONCINI. I do not understand why the tax gap increased.

Mr. EGGER. Because there is a continuing drop in compliance in this country. The answer to the compliance level is that it must be raised.

Senator DECONCINI. Have you concluded it has outgrown our ability to control it?

Mr. EGGER. Not our ability, but the resources we have to deal with it.

Senator DECONCINI. In other words, 490 positions is not enough?

Mr. EGGER. Absolutely.

Senator DECONCINI. What do you think it would take?

Mr. EGGER. We have proposed here, beginning in fiscal year 1987, to add 2,500 positions in the exam area alone each year for 3 years, a total of 7,500 positions.

Senator DECONCINI. That is a lot of people. But what troubles me is last year your request for 490 was supposed to narrow this gap.

Is that a miscalculation?

Mr. EGGER. No; there is a direct correlation of the expansion——

Senator DECONCINI. Had you not had the 490, then the gap would have been greater?

Mr. EGGER. That is correct.

Senator DECONCINI. And you are telling us that starting in 1987 that you have 2,500 positions every year for how many years?

Mr. EGGER. Three years.

Senator DECONCINI. What is that going to do to the tax gap?

Mr. EGGER. In the 3-year period, it will increase revenues by about $4.6 billion in direct collections. That is collections, that is not just assessments. That is the dollars we will collect.

That does not take into account any increase in compliance as a result of expansion of exam activity. I will be showing you some more detail on that as we go through the charts.

Senator DECONCINI. Those figures there, the blue figures are actual collected dollars?

Mr. EGGER. That is correct.

Senator DECONCINI. Not pledges, promises?

Senator ABDNOR. Go right ahead.

Mr. EGGER. As we go through these, some of the questions you have will be answered.

This shows what has happened to voluntary compliance in this country over the last decade or so.

Senator ABDNOR. What exactly is voluntary compliance?

Mr. EGGER. By voluntary compliance we mean the taxpayers who file their returns, and pay their taxes with no enforcement activity on our part at all.

That is dollars that come in.

Senator ABDNOR. Great American citizens.

Senator DECONCINI. That means no audits or anything?

Mr. EGGER. That is correct. I am saying without any enforcement activity that the dollars come in.

Senator DECONCINI. You do not know whether they are accurate? The 81.6 that comes in, no one has looked at them?

Mr. EGGER. Oh, absolutely.

Let me tell you how we got these figures. Every 3 years, we take a random stratified sample of 50,000 individual returns. The strata are by income level, economic activity, and return. These returns are subjected to a very intensive audit. Every single line item on the return is reviewed. The examining officer also probes for unreported income to determine the true tax liability.

The results of these audits form the basis for our statistical analysis of compliance.

Now, admittedly, this is only with respect to the returns that are filed. We do separate studies on nonfilers. But we have been accumulating these statistics for nearly 25 years, and we believe that the statistical analyses that we make are quite reliable. They are reviewed by the economists in the Treasury.

Senator DECONCINI. You are satisfied that 81.6 are good and clean or valid or whatever?

Mr. EGGER. Yes; they are as accurate as we can make them.

What has happened is that from 1974 to 1980, we dropped almost 2 percentage points. And then from 1980 to 1986, it looks like we dropped another half a point.

While that is a little better record than the 1974 to 1980 period in terms of a year-by-year timeframe, it is not that much better. The plain facts are that for every percentage point we drop in voluntary compliance, it costs the Treasury $5 billion each year. So, over a period of time, if you drop 1 percentage point, that means $5 billion this year and on and on.

Senator DECONCINI. In your opinion, how much of that do you think is attributed to the fact that we have such a complicated income tax system, thousands of pages, laws, and thousands of pages of regulations, and the 1040 form today, that has 38 more calculations than the simple form? What is your opinion?

Mr. EGGER. I think that the complexity is certainly a factor and the fairness element is perhaps even more of a factor. I think that the elements in the code which permit such things as front-ending of huge deductions, and so on, set up the opportunity for gaining on the system. The number and variety of deductions and credits in the system make it difficult, if not impossible, for us to police it as effectively as perhaps we should.

I think all of these factors point directly to the need for, in my opinion, the reforming of the system so as to try to weed out or eliminate as many of these difficulties as we can.

Senator DECONCINI. Thank you.

TAX GAP

Mr. EGGER. Let me go on to the next chart here. In this case we are looking at how much the tax gap has grown.

Back in 1974, we printed our figures backward to show that about $29 billion was the difference between the tax that was actually paid by taxpayers voluntarily, without enforcement efforts on our part, and the amount which should have been paid.

As you can see, that grew in 1980 to $62 billion. We have simply tabulated those figures forward to 1986. Our estimate from that extrapolation is that about $92 billion will be the size of the gap in 1986.

Using our enforcement activities, we will collect some of that money. For example, in fiscal year 1985, we expect to collect somewhere around $33 billion. It will not be out of one year, however. That $33 billion may very well be an accumulation of 5 or 6 years, bits and pieces of that tax gap.

I do not think we have ever been able to forecast how much of the $92 billion, for example, we will collect, but we will collect some.

REVENUE INITIATIVE

Let me go to the next chart. Here is the Grace Commission recommendation. This is the addition of our 7,500 positions over the 3-year period.

We start in fiscal year 1987. As you can see, the cost is relatively modest, as is the amount of revenue, about half a billion dollars. That grows rapid in the second year. In the third year, as you can see, we will collect up to $4.6 billion at a cost of about $600 million.

Senator DECONCINI. How do you project that?

Mr. EGGER. We have developed a very sophisticated staffing model in the IRS. The model has been reviewed by both outside contractors and OMB and has been pretty well accepted. It takes into account not only the direct cost such as salaries and so on, but also all the indirect costs of supporting the activities of those 2,500 positions.

We believe that it is a pretty accurate projection.

Senator DECONCINI. If I could ask another question.

Suppose that were revenue in 1979. Why do we not do that in 1986?

Mr. EGGER. The answer to that is that the administration has decided that in order to keep the freeze intact, it should apply to all of the agencies in the Government, and we are one of them.

Senator DECONCINI. If we gave you the positions, 7,500 positions, $600 million in 1986, do you believe that $4.6 billion figure could be achieved?

Mr. EGGER. No, sir; we could not absorb that much money in 1 year. The 2,500 positions is just a maximum, without having a diminishing return.

Senator ABDNOR. Is that not being a little hard of hearing, saying we are going to hold the line to put a principle in place to our detriment, and the very thing we are trying to overcome, deficits?

The same thing comes up in our other agencies—in customs enforcement.

Senator DECONCINI. If we have enough employees, we could balance the budget. [Laughter.]

Mr. EGGER. I do want to assure you that I do not believe Mr. Stockman would disagree with our projections. I have been over these with him.

Senator ABDNOR. You know, I get quite a following. I did not exactly make myself a hero when I signed my name to that document when it made it possible to transfer money to employees.

Out in South Dakota, you know, a couple of years ago, we ran out of money. I lost more votes by signing that piece of paper than I ever did by getting dollars out.

Mr. EGGER. The problem is, Mr. Chairman, that this agency collected 92 percent of all Federal revenues. And if this agency is not effective and does not work, then we are all in trouble.

Senator ABDNOR. I agree.

Mr. EGGER. Let me go to the next chart.

ENFORCEMENT REVENUE

This one is the revenue from enforcement. You remember, I spoke a little bit ago about the difference between the amount paid in without enforcement activity and what we collect as a result of enforcement.

These are based upon actual figures. We have used constant dollars here, so that there is no inflation in these numbers.

But take a look. Back in fiscal year 1980, we collected $22.4 billion of additional revenue over and above that paid in voluntarily. Our total budget at that time was $2.8 billion.

It went up in fiscal year 1982 to $25.9 billion, at which time our budget was still approximately $2.8 billion.

In fiscal year 1984, we jumped up to $3.3 billion, and our collections rose to $33.7 billion.

As you can see, we forecasted fiscal years 1985 and 1986 with almost no change in the budget, and again almost no change in the results.

So it is fairly clear, to me at least, that we have in effect plateaued out. That is to say, we have got about all we can get out of redirecting

our resources. Since fiscal years 1983 and 1984, I think we have achieved very significant results. The only difference is that now we are facing a flat line here.

Senator ABDNOR. What do we do now?

Mr. EGGER. We have already projected that in fiscal year 1987 we would begin to repeat that process.

MONITORING THE TAX SYSTEM

I might say it is not just a matter of collecting dollars, et cetera, it is a matter of preserving the integrity of the tax system.

In my judgment, monitoring the system is as important as the collection of a few more dollars of revenue. One of the interesting statistics here is that our yield to cost ratios have been pretty consistent for the last several years. In fiscal year 1980, it was $18 to $1. In fiscal year 1982, it went to $9 to $1. Then, in fiscal year 1984, it jumped to $10 to $1. Now, in fiscal years 1985 and 1986, it is dropping back to about $9.50 to $1.

The reason for this is principally the fact that, in fiscal year 1985, we are going to absorb about one-half of the pay raise of $33 million. This necessarily means we have to reduce the number of people onboard. It is just that simple.

I have sung my song, and I am prepared now to deal with any questions. I have brought quite a few people with me.

Senator ABDNOR. I must start out here on my favorite subject of motor vehicle lobbying. I do not know if you are aware of it. I had Secretary Pearlman in my office. I wish Senator Mattingly was here because I am not inclined to go his route.

I think Mr. Pearlman sees the writing on the wall, that some things may go the same way——

Mr. EGGER. He and I discussed this at length, Mr. Chairman, and we are both very, very aware of the public perception. We are aware of the concerns here on Capitol Hill.

We fully intend to work with the committees and with the members up here to see if we cannot find a solution. We must keep in mind that there is a necessity to enforce the appropriateness of those deductions and, at the same time, be as forbearing as we can be.

Senator ABDNOR. Senator DeConcini may not be one of those, but an awful lot of people have their name on it.

Senator DECONCINI. Mr. Chairman, I am cosponsor of your bill.

Senator ABDNOR. My office was aware of that before I was.

But the funny thing about it, as they keep reminding us, Congress did it. And not very many people, including those in the committee, seemed to realize what they had done. So I want you to know it is not a dead issue.

Senator DECONCINI. Mr. Chairman, could we ask the Commissioner if he has made any further changes in the regulations than what he told us?

Mr. EGGER. No changes.

We have 3 days of hearings set up for April 16, 17, and 18. We fully expect to take into account all the comments that either have come in or will arise in those hearings. We will then move as quickly as we can to try to implement some of the changes which we think are appropriate, given our statutory rules.

Senator ABDNOR. The hearings we hold?

Mr. EGGER. The hearings we will hold on the regulations.

Then, if that is not satisfactory, it is incumbent on the Treasury and Congress to work together to find a solution.

Senator DECONCINI. I think it is unfortunate, Mr. Commissioner, that that may be the only thing we do here. You may remember the record of the others.

It is like there is never a governmental agency, with or without direction, that does not overkill. The reaction is to overkill, and that is unfortunate.

Mr. EGGER. I agree with you, that it is unfortunate.

Part of our daily lives is to be sensitive to what does impact on taxpayers and how it impacts them. We hear a lot about that through the members of this body as well as the House of Representatives. We certainly pay attention to it, as we should.

Senator ABDNOR. Two approaches. I think Senators Mattingly and Bumpers have talked about attaching an amendment to another bill and hold funds for implementing of regulations. I guess that is one way of doing it.

Mr. EGGER. That is a poor way to write tax law.

Senator ABDNOR. And that is what we are coming down to. You start implementing funds on every provision, we would have a lot of those before we get through.

I guess with that, I will drop the subject unless there are any other things to say.

I would like to ask a few questions and we have a lot more for the record.

1985 PAY SUPPLEMENTAL

You are requesting $32.2 million for the 1985 pay supplemental. This is only 50 percent of the amount necessary to cover the increase. As a result of the absorption, you propose staff reductions of 802 positions.

Mr. EGGER. That is correct.

Senator ABDNOR. From what appropriations will these positions come? And what will the impact be on those activities?

Mr. TAYLOR. They will come from all four of our appropriations, Mr. Chairman, principally from appropriations two and four. We are attempting to protect the examination program as much as possible.

Senator ABDNOR. I am submitting some questions on behalf of Senator Chiles for the record, without objection.

Mr. EGGER. The 802 positions are going to come out of essentially all the programs. We are not reducing examinations.

Taxpayers service comes down just slightly, it does get its share, but not as much as in the administrative areas and the important areas.

Senator ABDNOR. Can I ask you this one?

Do you anticipate—as we ask most of our agencies—do you anticipate savings of $100 million as a result of a 5-percent pay cut?

How will IRS be impacted if it is not approved?

Mr. EGGER. If the 5-percent pay cut does not happen, and we do not receive the supplemental and then must fund that 5 percent it will take about the equivalent of 3,500 positions out of internal revenue for fiscal year 1986. That translates roughly into something like $500 to $700 million in revenue.

Senator ABDNOR. How many, about 3,500?

Mr. EGGER. Yes; about 3,500 overall positions.

Obviously, we would try to cover as many of those as possible in the nonenforcement areas. We have pretty well cleaned out that whole area and there is not much left in there.

GS-11 TO GS-15 INITIATIVE

Senator ABDNOR. How has the GS–11 to GS–15 initiative affected the IRS?

Mr. EGGER. We have worked with OMB in the area of reducing the number of GS–11 to GS–15's. A decision was finally taken not to apply that rule in the enforcement areas, but rather to apply it in the other areas.

Senator ABDNOR. Do you have to absorb other areas to offset the enforcement?

Mr. EGGER. No; we simply reduce. That is to say, we simply have not applied the reduction to them. By this we are saving about $5 million in fiscal year 1985. We will save a smaller number like $3.5 million or so in fiscal year 1986 by eliminating or restructuring, where we can, to reduce the number of positions.

Senator ABDNOR. I felt that Senator Specter was going to drop by. I think I will ask these for him.

PHILADELPHIA SERVICE CENTER

You answered the question many times before, but where are we on this Philadelphia computer problem?

Mr. EGGER. The specific problem in Philadelphia that was the subject of the hearing was a tape containing the payments for the third quarter of withholding and FICA taxes for about 26,000 taxpayer employers.

I believe that essentially all of those accounts have been corrected and straightened out. We have been in touch with the taxpayers. There were a few cases of offset. In other words, we have offset refunds from other accounts in order to cover the deficiency which grew up because we had not recorded the items on the tape.

I think all of those have been corrected. So I think we are in pretty good shape on that particular transaction, Mr. Chairman.

I want to assure you that we have gone to a considerable effort to strengthen our controls to see to it that kind of thing does not happen in other centers and that it does not happen again in Philadelphia. We are going to continue to see to that.

Senator ABDNOR. Senator Specter probably knows more than I do about it anyway. So we will be happy to relay this.

Mr. EGGER. I certainly do regret the incident, and we are doing our best to rectify it.

COLLECTIONS

Senator ABDNOR. In the past years we beefed up collections. This year we are reducing. Why the roller coaster?

Mr. EGGER. Primarily because of our automated collection system which went fully onstream in fiscal year 1984—excuse me, in calendar year 1984. We achieved through the implementation of that system savings of nearly 1,700 positions. That is a saving of nearly 1,700 positions in collections so that we are now able to collect more revenues more cheaply than ever before.

To give you some idea, our preliminary cost statistics on the system indicate that our collection case closings average, for that system, about $43 per closing. Today that average is down around $21 per closing. This is the kind of savings we have been able to achieve.

Senator ABDNOR. One last question, and then we will submit the remainder of my questions for the record.

TAX PROTESTERS

What is the current situation on tax protesters?

Mr. EGGER. The biggest element in the tax protester movement has been, in my opinion, the $500 penalty which the Congress enacted in 1982. The great majority of people who participated in some of these protester movements, or whatever, thought probably that they could do so with immunity even if it did not work. But, in fact, the $500 penalty has shed a whole different light on it.

A second factor, one which I think is terribly important, has been the prosecution and conviction of some of the ringleaders of these things. For example, down in the Southeast, we had one conviction that carried with it a fairly stiff sentence. Within weeks, we had 200 or 300 people coming in and saying, look, I do not want any part of that, I want to get straight and get my return filed, and on and on and on.

So these two factors, in my judgment, made a major difference.

Senator ABDNOR. I am glad to hear that.

MILEAGE RATE

Now I have a parochial question. One of my rural mail carriers in South Dakota has raised the question about mileage. We have it in writing. I will submit the question.

[The information follows:]

Since 1963 the Service has published a standard mileage rate for the purpose of relieving taxpayers from some of the burdens of keeping substantiating records of deductible automobile expenses. The Service now employs the services of a private transportation consultant, Runzheimer and Co., Inc., of Rochester, WI, for purposes of setting this rate, which is now 20.5 cents a mile. The standard mileage rate can be used by an employee to deduct transportation expenses for the taxable year with only the minimal requirement of substantiating the time, place, and business purpose of the trips involved; or, if an employer reimburses its employees using the standard mileage rate and receives from the employees substantiation of the time, place, and business purpose of the business miles driven, the employee in most cases need not include any of the reimbursements in gross income.

It has been the Service's experience that when another entity arrives at a mileage rate that varies from the standard mileage rate, that variance is caused by the use of a different methodology from that used under the Service's contract with Runzheimer. For example, if there is reflected in another mileage rate items the Service considers as separate deductions, such as finance charges, that rate will be higher than the standard mileage rate.

Under the Service's contract with Runzheimer, the standard mileage rate is based on a nationwide study of the weighted average cost of seven representative class categories of automobiles ranging from subcompact to full size and luxury automobiles. We believe the methodology provides a fair statistical average cost for both the taxpayer and the Government.

When dealing with averages there will be individuals whose costs are over the average as well as those whose costs are below the average. Individuals driving older, less expensive or new, smaller automobiles might find the average generous in their particular situations. Other individuals because of the cost of their automobiles or the type of road conditions they encounter on their jobs may incur costs at a rate in excess of the standard mileage rate in which case they are entitled to deduct their actual expenses if adequate records are maintained to substantiate such expenses.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Gentlemen, we could go on all day asking questions about IRS. That is not necessary. I think we have had a fine hearing and we appreciate your statements.

If you have any questions, do not be hesitant at all to come back and ask them.

This is not an easy year for us. We have always had discretionary spending in this area of the budget.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

STAFFING REDUCTIONS

Senator ABDNOR: For years the IRS has requested more people basing the argument that more people will generate more tax dollars. This year you propose to reduce staff by 664 positions, including a three percent reduction in the Collections, Appeals and Tax Litigation activity. What has caused the sudden change of heart? Have we closed the tax gap?

Mr. EGGER: The Service has argued that a carefully planned increase in enforcement staffing can generate additional revenue collections, reduce the size of the tax gap, or slow its growth. However, in support of the President's goal of reducing Federal outlays, program reductions are being made in FY 1985 to absorb fifty percent of the recent civilian pay raise and, in FY 1986, to cover inflationary costs. In subsequent years (ie., FY 1987-1989), the Service is planning a major revenue initiative which will result in collecting $4.6 billion in additional tax revenues by adding 2,500 positions, each year, to examine tax returns.

ISSUANCE OF REGULATIONS AND RULINGS

SENATOR ABDNOR: On page 5 of your justification you note one of your priorities will be to devote time and resources to issuing regulations and rulings and updating tax forms. I certainly hope the resources will be better spent than those that created the vehicle log regulations.

MR. EGGER: The Internal Revenue Service expects to use its resources in the most efficient and effective way possible. The vehicle log regulations were necessitated by section 179 of the Tax Reform Act of 1984, in which Congress addressed the recordkeeping issue by amending section 274 (d) of the Code to require that taxpayers substantiate by "adequate contemporaneous records" any investment tax credit or deduction with respect to expenses governed by section 274, including "listed property". Pursuant to that Congressional mandate, the Internal Revenue Service issued proposed and temporary regulations which followed the legislative intent of the provision as indicated in the various committee reports.

REVENUE INITIATIVE

SENATOR ABDNOR: You are reducing staff this year yet requesting 7,500 new people over three years for a major tax initiative. First, what is the initiative and second, is there ever going to be an end to hiring new people? I ask this because every time new tax law is discussed, more people are needed. Does that mean if we have significant tax reform, we are going to see large scale staff reductions at IRS?

MR. EGGER: In his report to the President, Peter Grace and his Commission noted that Examination staffing had not kept pace with tax return filings, and thereby recommended an increase of 7,500 average positions to the Examination program staffing over a three year period.

In response the Administration has proposed a revenue initiative that would add 7,500 average positions to the Examination program in 1987, 1988, and 1989 -- 2,500 average positions in each fiscal year. Over this three year time frame, this additional staff would generate actual revenue collecttions of $4.6 billion at a cost of $624 million. This represents a return of $7.40 for every dollar spent. Over a seven year period, this enforcement staff would generate $5.7 billion in actual revenue collections at a total cost of $665 million, a net return of 8.6 to 1. These yield and cost estimates are based on 2,500 average positions being available on October 1 of each fiscal year. The Service will begin advance hiring late in FY 1986 to ensure full revenue potential in FY 1987.

The Service cannot know what impact tax reform will have on its staffing needs until the details of a tax reform proposal are fixed. In the ongoing discussion of tax reform a number of proposals are on the table, but no consensus has yet developed on the likely direction of tax reform. When such details become known, the Service will be in a position to assess its staffing implications.

TRANSFER AUTHORITY

SENATOR ABDNOR: You are seeking five percent transfer authority. I don't know how other members of the committee feel, but I have seen very little justification for allowing your agency to transfer upwards of $50 million without approval of the Congress. Perhaps you could provide me with reasons this proposal should be approved?

MR. EGGER: Most agencies, including all the other Treasury bureaus, have one appropriation for operating expenses. The Internal Revenue Service has four separate operating accounts. Without specific authority, we cannot adjust resources to meet immediate workload demands or direct funds to cover mandatory cost increases. Currently, IRS has only limited authority, one percent.

In fiscal year 1986, the Service is facing significant resource problems including the need to (1) cover almost $200 million in cost increases by reducing and redeploying staff; (2) redirect $45 million in resources to implement tax provisions of the Deficit Reduction Act, for which only $10 million has yet been funded; (3) pay $20 to $30 million, in excess of the amount budgeted, to the General Services Administration for rent of space; and (4) cover mandatory cost increases, including the postal rate increase ($8 million) and printing of tax forms ($7 million).

By permitting IRS to shift resources, up to five percent, the Congress will be giving us the flexibility most agencies already have. Moreover, it will allow us to deal immediately with unforeseen problems, such as we are experiencing this year in processing tax returns, by shifting resources from less essential purposes.

I believe this transfer authority is crucial for me to administer a highly decentralized tax system in a responsive and effective manner. Your help in providing this authority would be greatly appreciated.

COST OF PRINTING TAX FORMS AND PUBLICATIONS

Senator ABDNOR: What is the current cost of printing tax forms and other publications? It is always hard to project usage, but overruns occur. Do you have any statistics on printing?

Mr. EGGER: In FY-1986, the IRS will spend approximately $51.6 million to print tax forms, instructions and publications. These funds will be used to procure over 102 million taxpackages and the cut sheet forms and instructions required to fill over 11 million taxpayer orders.

IRS has taken a conservative approach in estimating the number of cut sheet tax forms and publications to print. While this approach can result in the need to go back to press for certain items, I believe this decision helps to reduce overruns. Reducing the number of distribution sites from ten to three Centralized Inventory and Distribution System (CIDS) sites will provide us with better control over our inventories of printed material and enable us to eliminate unnecessary duplication.

The IRS continues to look for ways to improve dissemination of tax material. For example, we introduced the Library Reproducible Program in 1982. This program makes reproducible copy of the tax forms and publications available for copying at over 15,000 libraries across the country. Last year, the Southwest Regional Office developed a computer assisted market analysis of tax form distribution patterns within the region. Their analysis identified where we had too few or too many forms and resulted in a savings of $105,000 in printing. Efforts are underway to expand this program on a nationwide basis.

DIRECT DEPOSIT

Senator ABDNOR: Postage is also a big tab. Is the IRS working on direct deposit or other electronic refund mechanisms?

Mr. EGGER: As a part of a test on electronic filing of returns, we plan to test issuing direct deposit refunds to those taxpayers who participate in the test and who elect that option. In addition to the postage savings the Government will realize, the taxpayer will receive the benefits of saving the mailing time normally required, of greater security in the refund transmission, and of immediate access to the funds.

RETENTION OF TAX FILINGS

Senator ABDNOR: How long does the Service retain tax filings?

Mr. EGGER: Individual returns are retained in the Federal Records Centers for an average of 6 to 7 years. Corporation and Estate returns are kept for 75 years.

Senator ABDNOR: What is the cost?

Mr. EGGER: In Fiscal Year 1984, National Archives charged IRS $2.7 million to store IRS records. In-house storage costs amount to approximately $.3 million.

Senator ABDNOR: Can changes be made?

Mr. EGGER: IRS is continually reviewing its records series to determine if we can shorten retention periods. Continuing changes in the tax laws necessitate the varying retention periods. At Archives' urging, IRS has agreed to establish a 75 year period for corporation and estate tax returns. We are jointly looking into reducing the period we keep these returns. IRS and Archives are also exploring the feasibility of contracting out the storage and servicing of IRS records. In additional the Service is looking into the costs and benefits of converting large series of records to non-paper media.

SALARIES AND EXPENSES

Senator ABDNOR: The salaries and expenses account is being reduced by 135 positions. Where will these people come from? Will you have to RIF?

Mr. EGGER: The staffing reductions proposed for FY 1986 will come in our national headquarters office here in Washington and in our data center located in Detroit, Michigan. In the National Office, efforts are already underway to identify improved methods of accomplishing administrative services to eliminate unnecessary or overlapping work. In the Detroit Data Center, new systems to automate the processing of payroll documents will result in significant staff savings. Other workload is also being examined in the Data Center to identify ways we can achieve staff savings. In no case, will these actions require reductions-in-force. Some redeployment of personnel will, however, be required.

INSURANCE CLAIMS AND INDEMNITIES

Senator ABDNOR: There has been considerable fluctuation in the insurance claims and indemnities object classification. To what is this fluctuation attributable?

Mr. EGGER: Section 2741 of the Deficit Reduction Act of 1984 (P.L. 98-369) permits the Comptroller General to determine if the taxpayer is entitled to reimbursements for attorney fees and preparation costs. The budget reflects this new requirement in FY 1985.

REPRESENTATION FUNDS

SENATOR ABDNOR: The Request has a $25,000 Limitation for Representation Funds. How can the IRS justify this kind of expenditure?

MR. EGGER: The Service is requesting $25,000 in representation funds for the following purposes:

For many years, IRS has had a broad range of foreign related representation needs involving IRS overseas operations, tax treaties and visits by foreign tax and finance officials to the U.S. A small portion of these needs, primarily business lunches and dinners, has been met out of funds from the Secretary's representation funds or from the pockets of IRS employees. The majority of the needs went unanswered for lack of funds. Importantly, these needs are growing, reflecting the Service's rapidly increasing international activities including tax havens and narcotics. For these reasons, the Service decided to request its own representation funds to deal with this situation in a more business-like manner. We will maintain careful control and accounting of these funds. The primary areas in which the funds would be used are:

-Commissioner's Use-For protocol reasons the Commissioner must entertain high level foreign visitors when they come to Washington, D. C. or when he travels overseas.

-Examination, Criminal Investigation, Foreign Operations District-All the enforcement functions of IRS involved in international compliance efforts related to treaty agreements such as double taxation questions, simultaneous examinations, exchanges of information, and other cooperative efforts with foreign governments must offer hospitality to their foreign counterparts both overseas and when the foreign officials come to the U.S. Periodically the U.S. hosts the PATA (Pacific Association of Tax Administrators) or Group of Four meeting.

-IRS-Hosted CIAT Technical Conference-IRS is committed to hosting a CIAT (Inter-American Center of Tax Administrators) technical conference in FY 86. IRS is a member of this Western Hemisphere organization which fosters improved tax administration and communication among the tax agencies of the Western Hemisphere.

-International Visitors-IRS receives up to 500 official visitors from foreign tax administrations every year. As a courtesy it frequently becomes necessary to provide a luncheon during the visit. Many of these visitors are also officials related to cooperative efforts with IRS international compliance activities.

STAFFING REDUCTIONS

Senator Abdnor: The Budget proposes reduction of 424 Average Positions in the Processing Tax Return Account. You note this can be done by modifying current processing procedures. Won't this cost the government revenue?

Mr. Egger: This reduction will be achieved so that the impact on the revenue is minimized. Program reductions will be achieved in line with the Service goal of streamlining program support and not revenue producing operations.

Senator ABDNOR: You propose to reduce positions for the Employee Plans and Exempt Organizations activity. What is the reason? Won't this adversely affect compliance?

Mr. EGGER: The proposed reduction in staffing will delay our processing of Employee Plans determinations applications, but the employee pension plans will be reviewed to ensure that the rights and benefits of the plan participants are protected. The EP and EO examination coverage will be reduced somewhat, but we will continue to maintain minimum coverage in all categories of returns. Therefore, we do not anticipate that the proposed reduction in staffing will have a significant effect on compliance.

AUDIT CAPABILITY

Senator ABDNOR: What is going to be the general audit capability during FY 1986? How does this compare with past years? Is there anything besides increasing personnel that will increase this number?

Mr. EGGER: At this point, we expect in fiscal year 1986 to achieve about 1.2% coverage of income, estate, and gift tax returns. This compares to about 1.32% coverage that we estimate in fiscal year 1985, and the 1.31% that we achieved in fiscal year 1984. This is a downward trend that has continued for years as filings increase and we examine more complex, time-consuming returns.

Only by an increase in staffing could we increase coverage and maintain our commitment to a balanced program emphasizing high-yield and increased voluntary compliance.

I might note that the President's budget message provides for a major revenue initiative, endorsed by the Grace Commission, of increasing Examination staffing by 2,500 average positions each year over fiscal years 1987-1989. This would of course raise coverage as well as revenue.

STAFFING REDUCTIONS

Senator ABDNOR: The budget proposes significant reductions in personnel in the Investigations, Collection and Taxpayer Service account. Where will these positions come from? What impact will it have on operatons?

Mr. EGGER: The reduction of 1,138 average positions to this appropriation consists of reductions in the Tax Fraud Investigations (-74 average positions), Collection (-801 average positions), Taxpayer Service (-156 average positions), and Enforcement Litigation and Rulings (-107 average positions) programs. Portions of the reductions are attributable to productivity savings (-273 average positions), reductions in administrative overhead (-253 average positions), nonrecurring of limited duration staffing allocations, including the FY 1985 Congressional add-on to this appropriation (-204 average positions), and transfers to other appropriations (-202 average positions).

Program reductions will result in a loss of almost $150 million in revenue collected in FY 1986. This loss results from the requirement to absorb mandatory cost increases. However, it should be noted that revenue from collecting unpaid taxes and securing delinquent returns will increase by almost $400 million over FY 1985. This is due to improved productivity resulting from investments in ADP

and systems modernization, specifically the automated collection system which is now fully operational and new automation efforts planned for FY 1986 in the Collection field function.

TAXPAYER SERVICE

Senator ABDNOR: I am pleased that the Tax Counseling for the Elderly program will have $2 million for grants. Does IRS require an accounting from participating organizations? Could you describe what is required?

Mr. EGGER: The Tax Counseling for the Elderly Application Package requires prospective sponsors to submit a proposed program plan with their application. This application requires that the sponsor plan for an audit of the use of funds and establish internal controls. The plan is evaluated prior to selection. Subsequently, the selected sponsor's program is monitored throughout the grant period. The sponsor must provide IRS with the following information:

(1) A list of volunteers;
(2) A list of locations, dates and hours of operation;
(3) A monthly tally of the number of assistances provided.

Methods of reimbursement to the sponsoring organizations are set forth in the application package. Periodic reimbursements are made after the work is performed. Final payments are made after the report of work performance is submitted.

Periodic visitations by Internal Revenue Service staff are conducted to review program performance and financial records.

Senator ABDNOR: The Committee has received some indication that there is a problem with 800 numbers being busy all of the time; therefore, people cannot get through. Does IRS look at and monitor the 800 activity? Are adjustments made during the year ... i.e., the number of lines increased for peak times?

Mr. EGGER: We continually adjust our telephone circuitry and available staffing to meet the needs of taxpayers. Circuitry and staffing are added at peak times and reduced during less busy periods. Nevertheless, during peak periods it is sometimes difficult to reach our toll-free number. The best times to call are early in the day or during the latter part of the week when the demand for service is usually lower.

ORGANIZED CRIME DRUG ENFORCEMENT TASK FORCE

Senator Abdnor: The IRS has been very active in the 12 presidential task forces on organized crime. Do you feel IRS participation has been productive? Could you elaborate?

Commissioner Egger: Most definitely, the commitment of the Internal Revenue Service to the Organized Crime Drug Enforcement Task Force (OCDETF) program is the largest of the Treasury agencies. The IRS is providing 18% of the task force investigators and as of the end of 1984 has participated in 66% of the task force cases. As of January 31, 1985, the IRS has recommended prosecution on 787 task force targets, 538 informations and indictments were obtained, and 301 subjects have been convicted.

In comparing IRS task force cases with IRS non-task force cases completed in Fiscal Year 84, it is evident that a higher success rate is being achieved utilizing the task force approach. In addition, investigations are culminated in a shorter period of time, and are resulting in longer prison sentences and higher fines. It is equally evident that by combining the expertise of agents from other agencies with the financial expertise of IRS agents, the funds being generated from narcotics activities can be directly linked to expenditures being made by the narcotics traffickers. This greatly improves the government's chances for successful prosecution.

Lastly, it should be pointed out that with the Service's participation in task force investigations, wherein a financial approach is used in pursuing those who profit from illicit drug trafficking, professional members of society involved in this activity are being identified and prosecuted. The financial investigative approach used by agents of the IRS has made it possible to uncover those who finance these illicit drug organizations. This classification includes lawyers, accountants, doctors, stockbrokers and other wealthy businessmen.

TAX LIEN REVOLVING FUND

Senator ABDNOR: The federal tax lien revolving fund has been increased to $10 million. Is that enough?

Mr. EGGER: Yes, at this time we believe that the $10 million fund, when finally appropriated, is adequate for our current redemption needs. We will continue to monitor the fund to ensure its adequacy.

The redemption program has produced an average 86% return on the dollar over the last 3 years and is an excellent means of collecting revenue that otherwise would be lost to the government.

AT&T DIVESTITURE AND NOTICE 725

SENATOR ABDNOR: The IRS sent a letter to stockholders of AT&T indicating they must report dividends as a result of divesti-

ture. I was under the impression that no dividends were paid and that there is currently court action on this issue. I therefore would ask if maybe this notification was premature? Would you like to comment?

MR. EGGER: On January 1, 1984, American Telephone and Telegraph Company (AT&T) distributed to its shareholders , pursuant to its plan of divestiture, stock in seven regional holding companies. As a general rule when a corporation distributes property (cash or otherwise) to its shareholders, the distribution is treated as a dividend unless it qualifies under one of the exceptions provided in the Internal Revenue Code. One such exception is section 355 of the Code, which provides that stock of subsidiaries may be distributed taxfree if certain criteria are met. In the AT&T divestiture, we concluded that a portion of the Pacific Telesis Group (PacTel) stock distributed to the AT&T shareholders failed to meet the requirements of section 355 and should therefore be treated as a taxable dividend. The fact that the dividend was received in the form of stock rather than cash does not alter this result.

The ruling letter issued to AT&T set forth the Service's position as to the distribution of a portion of the PacTel stock. AT&T disagreed with our position and informed us that the Forms 1099-DIV, which AT&T was preparing for its shareholders to show the amount of dividends each shareholder received during 1984, would not include any portion of the distribution of the PacTel shares. Accordingly, Notice 725 was prepared and sent to AT&T shareholders to give them additional information they would need to correctly file their Federal income tax returns for 1984.

Finally, although judicial proceedings are anticipated as to the distribution of the PacTel stock, none is currently pending as to the substantive issue of whether a portion of the PacTel stock distributed to the AT&T shareholders constituted a dividend.

ADP AND SYSTEMS MODERNIZATION

Senator ABDNOR: IRS budget requests for the past three years have included substantial increases for ADP and Systems Modernization. You have told us that during FY 1985, the IRS would complete the five-year equipment replacement program, have installed the automated collection program, begun implementation of the automated examination program, and be well into design of the new tax system. Your progress in these major projects is commendable. We have reason to believe, however, that your plans have changed somewhat because of current operating problems. May we request, therefore, that you respond to the following questions:

The equipment replacement program was to carry the IRS through the 1980's, or until the new tax system could be installed. Is not the investment in this program exceeding estimates by a substantial margin? Are funds coming from curtailment of other planned projects? If so, what are these projects and your plans concerning them?

Mr. EGGER: Yes, the investment in this program is exceeding the original estimates which were developed to provide for a one-for-one replacement of aging existing equipment and a strict rollover of existing processing operations. The original estimates, developed under the guidance of a prior administration, did not make any allowance for cost beneficial enhancements or additions common to a system of this size and complexity. In addition, the system was sized very tightly and would accommodate only the processing planned at that time. Cost beneficial enhancements were implemented in consideration of the current Administration's emphasis on automation. Based on currently installed equipment, the actual costs through FY 1986 will exceed the estimated costs by $27.6 million. We are currently considering funding alternatives to accommodate additional requirements in the equipment replacement program along with our overall needs in the ADP and Systems Modernization area. Any shortfall will be addressed in total. Adjustments are being made to individual projects, but these are not associated with additional needs on a project by project basis.

Senator ABDNOR: The equipment replacement program, and certain other initiatives are directed primarily to the upgrade of computer hardware. There is some indication that service to taxpayers is deteriorating because information from the current tax system is not accessible on a timely basis. We understand this situation is critical in areas served by the larger Service Centers. What assurance do you have that for the next five years further deterioration of accessibility to information and substantial cost overruns to current systems will not continue?

Mr. EGGER: As I stated in my March 11th opening remarks before the House Ways and Means, Subcommitte on Oversight, all 10 IRS Service Centers have gone through the most significant phase of what we call SCRS, the Service Center Replacement System. Under SCRS, virtually all the basic hardware at the Centers and National Computer Center (NCC) was replaced. In addition, we shifted our programming language so that we would be able to write new programs more easily and efficiently.

As with any undertaking of this size a large number of transitional problems appeared. There is simply no way to avoid a shakedown period for working out the bugs in the equipment, the software, and the procedures for operation of any new system.

Because of some problems associated with the conversion process, our inventories of taxpayer correspondence and adjustments have increased during this period. This temporary increase in inventories is obviously not something we are attempting to excuse, but in the same respect, there is no reason to believe this situation will continue.

In fact, based on other ADP initiatives including the Microfilm Replacement System (MRS) portion of the

Equipment Replacement Program, improvements have been made in terms of the accessibility of information. MRS generated over 1,000 staff years in savings and reduced information turnaround time from several days to 24 hours. In the case of SCRS, we have accelerated the installation of equipment and as noted above the additional costs for this is more accurately depicted as the costs associated with the increased emphasis on the utilization of automated processes.

Senator ABDNOR: Planning for the new tax system began in FY 1982 and a project office was formally established at that time. An industry briefing held in June 1984 presented the scope, strategy and target dates for implementation. Funds have been included in budget requests since FY 1983 amounting to several million dollars. To our knowledge, a project manager has not been named. There is every indication that the planning process, now in its third year, has bogged down. In light of current problems with present systems, is the new tax system receiving the attention it should? If it is not your intention to pursue the program as presented at the industry briefing, what alternative plans do you have? We request that you provide, for the record, a summary of the tax system redesign project, or your alternative plan for replacing the current tax processing system. Please be specific regarding target dates for implementation and projected systems costs.

Mr. EGGER: Due to the breadth and scope of the Tax System Redesign Project, the Project Manager position has been elevated to the level of Assistant Commissioner and prospective candidates are currently under consideration for the position. Under the auspices of the Acting Project Manager, work continues towards development of the Request For Proposal (RFP) which is targeted for release toward the beginning of calendar year 1986. In addition, work continues on the documentation of the present system as well as selection of the project monitoring system to be used to ensure adherence to project benchmarks.

Procurement strategy has been proposed and is under active consideration with Treasury Department and GSA officials. We plan, during April, to update all industry representatives who attended the initial briefing in June 1984 with the progress to date and the latest estimated target implementation dates.

ABUSIVE TAX SHELTERS

Senator ABDNOR: The detection and pursuit of taxpayers involved in abusive tax shelters is one of the Internal Revenue Service's highest priorities. Abusive shelters are fraudulent schemes to evade taxes through investments which generate tax deductions and credits greater than the investor's cash outlay. In spite of the dedication of a large portion of the Service's resources and major legislative efforts by the Congress and the

administration, abusive tax shelter activity not only reduces revenues by billions of dollars each year but also decreases public confidence in the fairness of the tax system.

At the present time, IRS has about 350,000 tax shelter returns under examination. In addition, there is a large number of cases being considered by appeals and over 20,000 cases are pending at the Tax Court. The cases represent more than $10 billion in potential tax liability. The 96,000 shelter cases which IRS closed in 1983 represented only 1 percent of the individual examinations closed, but they contained 40 percent of the total additional taxes and penalties recommended by examination in individual tax cases in 1983.

What efforts does IRS have underway to deal with the shelter problem?

Mr. EGGER: The Service continues to devote large resources to the Abusive Tax Shelter Program. In fact, in the current Fiscal Year, we have allocated even more resources to the program than we have in prior years.

Our efforts are concentrated into two main areas: (1) closing out cases already under audit, and (2) detecting and stopping new abusive tax shelter promotions before they become widespread.

We have coordinated, at the National Office level, a Servicewide approach to complete the examinations of the partnership returns that have, thus far, stalled the closing of the investor returns around the country. The National Office, and our Regional Offices, are closely monitoring the efforts of the Districts in closing these cases. Where necessary, we have detailed Revenue Agents from some Districts to other Districts which have a serious backlog. This effort is beginning to pay off, and we expect to see very significant progress in closing out our existing inventory of cases in the near future.

We have efforts to detect and stop new abusive shelters. For example, we have established Abusive Tax Shelter Detection Teams at each of our Service Centers. These teams are composed of both Examination and Criminal Investigation employees, who physically inspect returns as they come into the Service Centers. Their primary goals are to identify new schemes, identify trends, and to assist the Districts in developing cases against the abusive tax shelter promoters.

The moment we identify a new scheme, we move quickly to see that the taxpayers involved are audited. Where appropriate, we tell our Service Centers to "freeze" the portion of the refunds attributable to the scheme. In some cases, we are able to identify the schemes even before the 1040's are filed. In these cases, we send pre-filing notification letters to the taxpayers advising them we will disallow the deductions and tax credits from the schemes if they claim them on their returns.

We especially focus on abusive tax shelter promoters. The Applications for Tax Shelter Registration Numbers, which are filed as soon as the promoters begin selling the schemes, provide

us with leads on which our agents in the districts follow-up. When we find that someone is promoting an abusive scheme, we impose the penalties provided for by Code section 6700. Where it appears that there is a continuing pattern to a promoter's activity, we refer the case to the Department of Justice, for injunction action under Code section 7408, which is intended to make the promoter stop the activity permanently.

Senator ABDNOR: How many tax shelter examinations is IRS currently planning for 1986?

Mr. EGGER: The Service is committed to examining all the abusive shelter returns that need to be examined; shelters is our #1 priority. About 114,000 examinations were concluded in fiscal year 1984. I think we can expect a somewhat higher figure in fiscal year 1986.

Senator ABDNOR: What is the projected tax and are penalties expected in result from those examinations?

Mr. EGGER: In fiscal year 1984, we recommended about $2.2 billion in additional taxes and penalties from the examination of tax shelters. That figure will likely be somewhat higher in fiscal year 1986.

Senator ABDNOR: How much will shelter enforcement cost IRS?

Mr. EGGER: Our commitment is to examine all the abusive tax shelters that need to be examined; shelters is the Service's #1 priority. While we don't know exactly what the examination of shelters will cost in fiscal year 1986, we do know that we spent about $350 million on such examinations in fiscal year 1984, and that amount is likely to increase somewhat in subsequent fiscal years.

Senator ABDNOR: Are the enforcement powers IRS currently has adequate to deal with the abusive shelter problem?

Mr. EGGER: Recently enacted legislation, such as IRC 6700 and 7408, has provided the Service with a means to penalize organizers of abusive tax shelters and to enjoin them from further selling activity. Tax shelter registration provides a method to identify these tax shelters at the initial marketing stages. While it is too early to determine if registration will achieve its objective, it may turn out that the IRC 6700 (for promoting abusive shelters) penalty and the penalties provided in IRC 6707 (failure to furnish information) are too low. These penalties may not be significant enough in many instances to deter organizers.

Senator ABDNOR: How much of IRS' resources have been redirected from the regular compliance program to the tax shelter program? What impact, if any, has this had completing the regular tax compliance program?

Mr. EGGER: The Service has not received any separate appropriation for tax shelters. In effect, all of the resources

we apply to tax shelters are resources that we would otherwise apply to examining returns in the "regular" program.

The impact on the "regular" program is that we are examining fewer non-shelter returns to the extent that shelter returns are devouring our resources.

Senator ABDNOR: How many returns in the closing fiscal 1984 tax shelter inventory has IRS reviewed for non-shelter issues and on how many returns were non-shelter issues raised? Does IRS plan to scrutinize the balance of these returns for non-shelter issues?

Mr. EGGER: The closing fiscal year 1984 tax shelter inventory stood at about 337,000 returns (the count at January 31, 1985, was 372,000). All of these returns were initially classified for both shelter and non-shelter issues. Those with non-shelter issues were examined for those issues and are now awaiting determination of the shelter issues. We have no separate count of cases that had non-shelter issues.

ABUSIVE TAX SHELTERS

SENATOR ABDNOR: IRS Counsel and Appeals have generally been offering out-of-pocket settlements on returns involving questionable tax shelters. Is this program considered successful? Is there a difference in the settlement rate based on the amount in question; i.e., as the amount in question increases, the settlement rate decreases.

MR. EGGER: In August, 1982 the Service announced a policy (P-4-64) of allowing Examination to administratively dispose of out-of-pocket expenses (cash investment) as a deduction in the initial year of investment. This policy, although never formally extended to Appeals and Counsel, became a benchmark for applying the hazards of litigation settlement standard in Appeals and Counsel. The out-of-pocket settlement program did not succeed in disposing of the number of cases originally anticipated, so it was not extended to post-1980 tax shelters. In 1984, the IRS strengthened its out-of-pocket stance for pre-1981 cases by withdrawing offers which were not accepted within a reasonable period.

We have only noted a difference in the settlement rate based on the amount in question where the deficiency is quite small. In those cases, the taxpayer would most likely settle. We have not noted any correlation between the amount of deficiency and the settlement rate in cases other than those involving quite small deficiencies.

Senator ABDNOR: Could IRS significantly reduce their tax shelter workload by waiving interest, penalties, or both, for taxpayers who would be willing to settle their tax shelter cases for out-of-pocket expenses during a given time period?

Mr. EGGER: We do not believe waiving interest or penalties on returns with tax shelters issues is a viable alternative. This would amount to amnesty for a small group of

high income taxpayers. We are concerned that instituting amnesty for investors in tax shelters might encourage the belief that similar offers would be repeated in the future. The results would be lower compliance levels in the interim. In addition, other taxpayers may perceive an amnesty as "special treatment" for taxpayers who invest in abusive tax shelters, thus further eroding voluntary compliance.

In 1982, I authorized field officials to use an administrative approach to dispose of certain tax shelter program cases. The Service has issued guidelines and authority to close certain 1980 and prior tax shelter returns, allowing the taxpayers to deduct, in the initial year of the investment, an amount equal to the cash invested. The administrative offer applied to all pre-1981 returns except those designated as litigating vehicles, or criminal investigation cases.

The result of our administrative offer was less than satisfactory. While the reasons were many, the majority of the taxpayers questioned gave the following reasons for not settling their cases.

1. The key case or similar case was in litigation and the investors believed the courts would allow a deduction greater than the cash invested;

2. The promoter/salesman/representative told the investors not to accept the offer, they have nothing to lose by going to court; and

3. A large number of the taxpayers invested in multiple tax shelters. Some tax shelters would qualify for the administrative offer; other tax shelters would be designated as litigating vehicles or criminal investigation cases, thus preventing the Service from closing the taxpayer returns until all of the shelter issues were resolved.

To overcome these last obstacles, we analyzed the tax shelter inventory to identify groups of cases/promotions that contained large numbers of investors, common issues, and issues controlled by existing precedents. From the initial review, we selected 12 promotions containing 174 key cases for expeditious examinations. By using computers to analyze the 174 key cases we were able to identify 19,015 primary investor returns. Our analysis of the 19,015 investor returns disclosed that they were involved in 3,057 other blocking shelters. We have provided the field offices with the identity of the primary investors and blocking shelters in their regions. We instructed the field to devote the necessary resources to finish the examination of the 3,057 blocking shelters. Once these are closed, we will be in a position to close the 19,150 primary investor returns, plus the single issue investor returns in the 3,057 blocking shelters. Our current plans are to repeat this process until all of our pre-TEFRA tax shelter inventory is closed.

Senator ABDNOR: Has IRS stratified their tax shelter inventory to determine which shelters, if any, might be considered only marginally worth pursuing?

Mr. EGGER: We pursue shelters that have the greatest potential for adjustment; we do not pursue marginal cases.

The tax shelter inventory is stratified by type (real estate, oil and gas, etc.) to compile statistics on tax shelter open inventories and examination closure results.

The open and closure statistics together help to determine what types of tax shelters are widespread and what closure results can be expected from examination.

Senator Abdnor: Abusive tax shelters often involve fraudulent tax behavior, such as selling deductions based on nonexistent property, backdating documents and exorbitant overvaluations.

To what extent have criminal charges been brought against promoters and investors?

Commissioner Egger: As a result of the increasing number of abusive tax shelters, the Criminal Investigation Division instituted an Abusive Tax Shelter Project in 1977. The major thrust of criminal cases developed by this project was directed toward the promoters, salesmen and key associates of these abusive shelters.

Statistics available from fiscal year 1980 forward indicate increasingly significant accomplishments by Criminal Investigation in connection with this project. In fiscal year 1980, Criminal Investigation initiated 92 cases. In fiscal year 1981, this figure rose to 103, increasing to 178 in fiscal year 1982. While there was a slight drop-off to 152 cases initiated during 1983, this figure increased significantly in fiscal year 1984 to 224 cases. The increase in prosecution recommendations has been equally impressive increasing from 31 in fiscal year 1980, to 66 in fiscal year 1981, 102 in fiscal year 1982 and 108 in fiscal year 1983. There were 105 prosecution recommendations made during fiscal year 1984. Thus far, in fiscal year 1985, Criminal Investigation has initiated 36 investigations and made 33 prosecution recommendations.

Senator Abdnor: What have been the results?

Commissioner Egger: In fiscal year 1980, seven indictments or informations were returned in investigations involving abusive tax shelters. This figure increased substantially in fiscal year 1981 to 39. There were 40 indictments or informations returned in fiscal year 1982, 44 in fiscal year 1983 and 49 in fiscal year 1984. Thus far, in fiscal year 1985, there have been 10 indictments or informations returned in cases involving abusive tax shelters. In fiscal year 1980, there were only three convictions in cases involving abusive tax shelters. However, this figure increased to 13 in fiscal year 1981, 33 in fiscal year

1982, 34 in fiscal year 1983 and 31 in fiscal year 1984. There have been 13 convictions thus far in fiscal year 1985.

Senator Abdnor: What portion of Criminal Investigation Division's resources are being used to attack abusive tax shelters?

Commissioner Egger: For the fiscal year 1984, the Criminal Investigation Division spent 156 staff years on investigations involving abusive tax shelters. This figure has steadily increased since fiscal year 1980.

It should be noted that Criminal Investigation's efforts in abusive tax shelter cases are almost always directed toward the more culpable individuals involved in a scheme. These individuals are usually promoters or salesmen and they are relatively few in comparison with their clients. The criminal act is often conspiracy, which is generally less time consuming to investigate than Title 26 income tax violations.

It is anticipated that the above figures will be significantly higher for the fiscal year 1985 due to time now being expended in identifying abusive tax shelters through service center Abusive Tax Shelter Detection Teams. These teams were only recently formed and statistical data regarding resources utilized is not currently available.

Senator ABDNOR: The Tax Equity and Fiscal Responsibility Act of 1982, (TEFRA), provided IRS several enforcement tools to use in combating abusive tax shelters, including the use of injunctive authority against promoters of abusive tax shelters.

Has the tax shelter promoter injunction program been effective in curtailing the use of abusive tax shelters?

Mr. EGGER: I believe the Service's injunction program has been effective in curtailing some of the promotional activity of abusive tax shelter promoters. Our program has achieved a substantial amount of publicity which, of course, is not measurable in its effect on tax shelter organizers. Nevertheless, our program is widely discussed in the professional community, which has assisted us in our efforts.

Senator ABDNOR: How many injunction requests have been forwarded to the Department of Justice in each of the last two years, and how many have been granted?

Mr. EGGER: 131 injunction requests have been forwarded to the Department of Justice during the last two years; 41 were forwarded in 1983 and 90 were forwarded in 1984.

Suits have been filed on 68 of these cases, resulting in 38 injunctions through either consent decree or trial.

Senator ABDNOR: Another tool available to IRS is the pre-notification letter whereby an investor is informed that a shelter in which the investor has an interest has been determined by IRS to be abusive. The letter states that if the investor claims the deductions, the investors' returns will be audited and deductions and credits related to that shelter disallowed. Late in 1984 IRS reported that, in a sample of cases, about 97 percent of the investors who received these letters had claimed the deductions anyway.

Is that trend continuing?

Mr. EGGER: The rate at which recipients of pre-filing notification letters are claiming the benefits of the shelters they have invested in was 84 percent as of February 28, 1985. This is somewhat better than the 97 percent quoted earlier, but still represents only a 16 percent compliance rate.

Senator ABDNOR: What steps is IRS taking in these cases?

Mr. EGGER: The Service is making every effort to locate and inspect the returns of the taxpayers who have received pre-filing notification letters. If the abusive tax shelter benefits have been claimed on any of these returns, the benefits are disallowed and the appropriate penalties assessed. The Service is also inspecting the subsequent year return to determine if the benefits are claimed again.

Senator ABDNOR: One way IRS addresses this problem is to hold up and or reduce refunds due to these investors. Is this a reasonable approach?

Mr. EGGER: I think so. As I stated in my address before the AICPA's Tax Division meeting in December 1984, a review of our service center operations clearly indicates that a growing number of middle-and-lower-income taxpayers are using "quick" refunds to subsidize their investments in tax shelters. Many of these people lack the up-front cash to buy into shelters but are gullible enough to listen to shelter promoters who convince them to commit their expected tax refunds as collateral against loans from the promoters.

By freezing the portion of the tax refund attributable to the shelter this reduces the financial impact on taxpayers who might otherwise be unable to pay the deficiencies and penalties at a later date.

Senator ABDNOR: To what extent have pre-notification letters to taxpayers been used, and how effective have they been in curtailing deductions by taxpayers who have invested in abusive tax shelters?

Mr. EGGER: Pre-filing notification letters have been considered for all promotions where the IRC 6700 penalty criteria exist. These criteria are that the promoter must have made a false or fraudulent statement or there must be at least a 200 percent overvaluation. We have issued 22,000 of these letters, and to date only 16 percent are not claiming the tax shelter

benefits on their returns, but it is possible that the knowledge of the program may be discouraging other potential investors from investing.

Senator ABDNOR: The Tax Reform Act of 1984 requires that new shelter promotions be registered with IRS and that taxpayers subsequently reflect the promotion registration number when reporting the pro-rata share of operating results on their individual tax returns. However, IRS is not required to perform any review of the shelter or its proposed operations before issuing a registration number.

How many abusive shelters has IRS identified through the program?

MR. EGGER: It's really too soon to tell. As of March 29, 1985, the Service had received 12,394 applications for registration.

As of February 28, 1985, approximately 1,300 leads had been referred to districts based on applications indicating an abusive shelter was possibly being promoted.

Senator ABDNOR: How much will the registration program cost IRS in fiscal year 1986?

Mr. EGGER: We estimate that the fiscal year 1986 cost of tax shelter registration will be about $22 million.

Senator ABDNOR: Are further modifications to the legislation or regulations needed?

Mr. EGGER: While it is too early to determine whether registration has achieved its objective, it may turn out that the penalties provided in Section 6707 are not significant enough in many instances to encourage registration.

Senator ABDNOR: Before issuing registration numbers, should limited partnership tax shelter promoters be required to apply for and receive approval as non-abusive tax shelters, similar to procedures now in effect for tax exempt organizations? If so, should approved shelters be required to submit operating results annually in order to obtain continuing approval?

Mr. EGGER: The resources necessary to carry-out such a massive endeavor would be prohibitive. As we learn the effect that current registration and other measures have on the tax shelter program, we will be in a better position to evaluate possible enhancements.

Senator ABDNOR: Should IRS have authority to disallow losses on individual tax returns from limited partnership tax shelters if such promotions were not formally approved by the IRS?

Mr. EGGER: Because the resources necessary to carry-out a non-abusive tax shelter approval process would be prohibitive, we would not look to get such authority.

CASH MANAGEMENT INITIATIVES

Senator ABDNOR: In a November 1983 report, (GAO/GGD-84-14), GAO pointed out that the Treasury Department and IRS had made significant progress in expediting the deposit of tax receipts, thus improving the Government's cash management. GAO also pointed out several areas where improvements were still possible which included reducing the numbers of Federal Tax Deposits which are sent to IRS offices instead of finacial depositaries, accelerating the deposit of tax receipts at IRS field offices and computing the cash management savings associated with the procurement of check sorting equipment.

What steps has IRS taken to address GAO's recommendations? Also, what will be the resulting costs and interest earnings for implementing any planned actions?

Mr. EGGER: After an extensive publicity campaign that included news releases, information notices in return mailouts, and revised instructions in tax returns and publications, we began to assess penalties for Federal Tax Deposits that are sent to IRS offices instead of financial depositories. This program became operational in November, 1984. An estimated $4.9 million in interest revenue could be realized if FTDs are deposited at financial institutions. The cost to assess these penalties is approximately $1.2 million.

The accelerating of the deposit of tax receipts at IRS field offices was accomplished by allowing the field to deposit remittances at the point of receipt. This is in lieu of transshipping to the regional service centers. In addition, the field offices began to function under the same deposit cycles as the regional center, which requires that remittances be deposited within 24 hours of receipt. Projected benefits are $7.1 million annually.

Cash management savings relating to the acquisition of check sorting equipment is estimated at $24.3 million annually. This information was the result of an analysis completed by the Financial Management Service at our request. The cost to acquire the equipment is $11.6 million spread over a six year period.

Senator ABDNOR: What other cash management initiatives does IRS plan for fiscal year 1986 and what will be the associated costs and interest earnings?

Mr. EGGER: We have begun a pilot test to determine the effectiveness of processing certain tax remittances at commercial check processing centers, referred to as a Lockbox. The concept is that by directing the checks to a designated Lockbox, the Treasury will realize earlier credit availability because of decreased mail and check clearing float. The test is being conducted on 1040 Estimated Tax payments for taxpayers residing in the State of Illinois. Estimated benefits are projected at $25 million at a cost of $6 million if implemented Nationwide.

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Another test is being conducted whereby the Service would automatically charge taxpayer bank accounts for delinquent tax installment agreements. Savings are projected at $2 million annually with costs to be determined during the pilot. The pilot is in process and affects taxpayers in the states of Michigan and Ohio.

CHARITABLE CONTRIBUTIONS

Senator ABDNOR: The deduction for charitable contributions was recently estimated to effect a revenue loss of over $8 billion. In order to minimize loss from nonqualifying and overvalued contributions IRS must ensure that charitable contribution deductions are accurate.

What does IRS do to inform individuals that tax-exempt organizations continue to be eligible for exemption?

Mr. EGGER: The Service publishes Publication 78, Cumulative List of Organizations described in Section 170(c) of the Code, which lists organizations to whom contributions are deductible. The publication is updated and reissued annually and additions to the list are published in cumulative quarterly supplements. The extent to which contributors may rely on the listing of organizations in Publication 78 for purposes of deductibility and the procedures for revoking reliance are contained in Revenue Procedure 82-39. In general, contributions will be deductible by persons unaware of a change in an organization's status until the date of publication of an announcement in the Internal Revenue Bulletin that contributions to the organization are no longer deductible. In addition to this, upon request the Service issues rulings to individuals on whether a proposed contribution to a particular organization will be deductible.

Senator ABDNOR: What does IRS do to aid individuals in determining what portion of their contribution to a qualifying organization is eligible as a charitable contribution when organizations engage in both qualifying and non-qualifying activity, or the individual receives a benefit in return?

Mr. EGGER: Taxpayer Service assistors are trained to advise taxpayers whether contributions to particular organizations are allowable charitable contributions. Questions regarding the qualifying or non-qualifying activities of an organization (i.e., unrelated business income) would generally be referred to Taxpayer Service Specialists for necessary research. Assistors advise taxpayers that factors such as the value of any benefit received must be considered in determining the actual deduction allowed, using guidelines in Publication 17, "Your Federal Income Tax," or Publication 526, "Charitable Contributions." These publications are available to taxpayers upon request. In addition, the Service distributes information materials to the media which address the deductibility of charitable contributions.

CIVIL PENALTIES

Senator ABDNOR: The Internal Revenue Code contains over 75 civil penalty provisions for violations of its reporting and payment provisions. These provisions have been added piecemeal to the Code as new requirements have been legislated and are intended to impress upon taxpayers the significance of their Federal tax obligations, to provide meaningful incentives for compliance, and to compensate the Government for the expense of investigation and collection.

One of the major objectives of TEFRA was to improve taxpayer compliance. In this regard, it introduced several new penalties and increased the minimum assessment on others.

Has IRS taken the necessary administrative steps to implement these provisions?

Mr. EGGER: The Internal Revenue Service has taken all steps necessary to implement the penalties introduced by TEFRA. While Regulations have not been approved for all TEFRA penalties, our examiners have been provided additional guidance in the form of Revenue Procedures, Internal Revenue Manual instructions, or memorandums. In addition, special procedures have been implemented to insure the fair and equitable application of these penalties.

In order to improve taxpayer compliance in the area of information return filing, special projects have been undertaken since the enactment of TEFRA.

We have developed a data base, which we call the Payer Master File. Using data from information returns filed for 1982 and subsequent years, this system is already identifying payers who stop filing information returns. We are then following up to determine whether returns are in fact due. In the near future, this system will perform sophisticated analyses of business and individual income tax return data to determine whether related information returns might be required and have been filed. If it is indicated that returns might be required but have not been filed, the Service will follow up and secure any returns due. This type of linkage between information returns and tax returns will allow us to associate leads from one source to another to improve compliance with all filing requirements.

Beginning in January 1986, returns filed for 1984 will have been analyzed, and educational notices will be sent to those taxpayers whose returns indicate that an information return may be due. Information returns will be solicited in 1987 for filing requirements identified on 1985 tax returns.

In response to the increasing emphasis on penalties, the Service has fully automated the means used to make assessments for violations of information return filing requirements, allowing these penalties to be assessed as returns are processed.

In addition to providing for the processing of Forms 8210 (Self-Assessed Penalties Returns), used to report failures to file and furnish information documents and taxpayer identification numbers, the service centers are preparing to assess penalties on information returns filed after the due date.

The penalty will be asserted on all information statements 1099, Forms W-2G (Statements for Recipients of Certain Gambling Winnings), and Forms 5498 (Individual Retirement Arrangement Information) which are received after their respective due dates in 1985 and thereafter.

During the service center processing of Form 990 Series and Form 5500 Series returns, the Service also assesses penalties on exempt organizations and employee plans that fail to timely file required returns or file returns that are incomplete.

Senator ABDNOR: Does IRS have sufficient resources to enforce these as well as the other penalty provisions?

Mr. EGGER: For the present, we think the resources available for this purpose are pretty much in balance with overall Examination resources and coverage.

Senator ABDNOR: IRS is devoting considerable efforts into curtailing abusive tax shelters. How much has IRS assessed in the last five years in penalties from examinations of abusive tax shelter schemes? How much of that has actually been collected?

Mr. EGGER: In fiscal year 1984 (the first year the penalty could be imposed), the Service imposed $3 million in penalties under section 6700. In fiscal year 1985 through the end of February, this number had already increased to $18 million.

Other penalties are not separately tracked in our system; they are lumped together with additional taxes. I'm afraid I can't be more helpful. Of course, the amount of the other penalties is substantial.

Likewise, our systems do not track the collection of subsets of our aggregate examination results. Over all, we ultimately collect about 95% of our assessments. This is probably a bit less with shelters - because of appeals and litigation - but is certainly still substantial.

Senator ABDNOR: The Treasury Department's November 1984 proposal for tax reform recommends that the current penalty for failure to pay taxes be eliminated and replaced with a "cost of collection charge." Does IRS currently have a basis for accurately determining the "cost of collection" in each instance?

Mr. EGGER: We do not track collection costs on a case-by-case basis. We do have a management information system which provides total costs associated with collection activities. Utilizing these costs, we can arrive at an average cost of collecting delinquent accounts.

Senator ABDNOR: Treasury's proposal also recommends that all statutory maximum amounts on fixed dollar penalties be eliminated. Has IRS made any estimates of how many taxpayers would be effected or of the additional revenue that would result from such a change?

Mr. EGGER: At this time, IRS has not made any estimates or conducted any specific studies on the additional revenue that would result from eliminating maximum amounts on fixed dollar penalties.

Until the implementation of the Civil Penalty Master File, all civil penalties were manually assessed and were maintained on a Non-Master File account. Estimates on the effect of the penalties or the additional revenues that would result were difficult to determine. However, on May 1, 1985, the Service will begin nationwide implementation of the Civil Penalty Master File. All penalties on the Master File will be assigned a unique reference number which will identify the exact penalties assessed and permit us to determine the impact of the various penalties.

Senator ABDNOR: The Economic Recovery Tax Act of 1981 and TEFRA provided IRS with additional penalties to assess for filing false W-4 forms and for filing frivolous income tax returns such as those filed by tax protestors. For example, IRS imposes a $500 penalty on false W-4 statements filed. Two years ago, IRS expected to review 500,000 questionable withholding cases by examining exemptions claimed on form W-4.

To What extent has IRS used the penalties recently authorized?

Do you believe that such penalties can successfully combat tax protestors?

Now that IRS has gained some experience in this area, do you think that additional measures will be required?

What were the results of IRS' review of forms W-4? Is the level of questionable withholding increasing?

Mr. EGGER: In FY 1983, the IRS examined 417,895 questionable withholding cases with assessments in 81,774 cases of which 14,538 were subsequently abated. In FY 1984, the IRS examned 306,472 cases with penalty assessments in 85,253 cases of which 20,131 were subseuqnetly abated.

The extent to which these penalties have been successful in combating these types of protestors is not yet clear. We have developed a strategic initiative, SVC-1, which establishes a research project on withholding non-compliance. The overall objective of the project is to assess the extent and nature of all the problems in the Withholding Compliance area, including the W-4 problem, in order to make recommendations for improving the effectiveness of tax administration. Preliminary indications are that, although not directly measurable, withholding noncompliance may be shifting from W-4 non-compliance to other areas such as employers not properly classifying their workforce.

Whether the penalties provided for dealing with the W-4 problem are responsible, directly or indirectly, for that shift is not known. The strategic initiative study will help us detetermine those legislative, regulatory, or programmatic changes necessary to further combat withholding non-compliance.

With regard to the penalty for filing frivolous income tax returns, we are developing a study which will help us assess the impact of this penalty on the tax protestor movement.

SENATOR ABDNOR: IRS regulations provide employers with a "safe haven" if they make timely deposits of at least 95% of their withheld income tax and social security liability. Employers can take advantage of this situation by delaying deposits of up to 5% of their tax liability for a period of up to 56 days. This so called "safe haven" rule is intended to preclude employers from paying a penalty if they cannot determine their actual liability in time to make deposits within the required 3 banking days after the end of the liability period. The regulations do not preclude employers from using the rule even if they can determine their actual liability.

In August 1984, IRS' Internal Audit Division reported that certain large employers were taking advantage of the rule by making only 95 percent of their required deposits even though they were able to determine their actual liability. Based on its sample of 78 large corporations, Internal Audit estimated the Government was losing over $435,000 in foregone interest alone. Internal Audit recommended that IRS consider changing the regulations to eliminate the unintended benefits to very large corporations that take advantage of the "safe haven" rule.

In view of the significant impact of such a change on government's cash management, what change in tax regulations relating to the use of the "safe haven" rule does IRS plan to make?

MR. EGGER: Section 31.6302 (c)-1 (a) (1) (i) (b) provides that employers who make an eighth-monthly deposit of social security and withheld income tax will be deemed to have made a timely deposit if at least 95 percent of the tax due was deposited by the specified due dates. This rule is commonly known as the 95 percent "safe haven". The Internal Revenue Service is studying whether regulations should be published that would accelerate deposit of the "safe haven" amount.

SENATOR ABDNOR: When does IRS expect to issue such regulations?

MR. EGGAR: The Internal Revenue Service anticipates that in view of the pressing workload from the 1984 Tax Reform Act and earlier Acts, our study would not be completed until later this year and any regulation would not be published until 1986.

CLAIMS FOR REWARD PROGRAM

Senator ABDNOR: Although voluntary compliance is the cornerstone of our nation's tax system, more and more persons are failing to abide by the tax laws particularly by not reporting or underreporting their taxable income. While IRS has various tools

for detecting noncompliance, the Claims for Rewards Program is one of the few tools IRS has for detecting taxes lost through cash transactions or transactions involving little or no documentation.

What plans, if any, does IRS have to enhance the Claims for Rewards Program?

Mr. EGGER: We believe the program is currently appropriate and we plan no enhancements.

Senator ABDNOR: Does IRS have any plans to revise the rewards formula?

Mr. EGGER: On December 12, 1983, we increased the maximum reward payable from $50,000 to $100,000. We do not think it appropriate to make further changes at this time.

Senator ABDNOR: Does IRS have any plans to educate the public about the program and about the kinds of information IRS needs to initiate cases so as to improve the quality of the information received?

Mr. EGGER: We do not plan an aggressive public education program at this time.

We are exploring a revision to IRS Publication 733 (Rewards for Information Given to the Internal Revenue Service) to include a section dealing with the information which would be useful to the IRS in investigating violations of the tax laws. This publication is provided to interested parties at their request.

COLLECTION ACTIVITIES

Senator ABDNOR: During the past few years a number of attempts have been made to reduce the amount of delinquent taxes owed to the federal government. These attempts included increased IRS collection staffing and automation of the collection process. During last year's appropriation hearings, IRS mentioned that these attempts helped reduce the outstanding delinquencies by 5 percent to $23.4 billion at the end of fiscal year 1983.

Have the outstanding delinquencies increased or decreased this past year? What was the outstanding delinquency balance at the end of fiscal year 1984?

Mr. EGGER: The amount of delinquent taxes owed at the end of FY 1984 was $29.4 billion.

Senator ABDNOR: To what does IRS attribute this increase or decrease in delinquencies?

Mr. EGGER: A significant portion of the growth in delinquent taxes is due to the growth in the economy and in the significant

increases in withholding and social security taxes. The largest increases are in notice inventory and system monitored cases, (bankruptcy, litigation, etc.) areas where we are limited in the steps we can take to effect collections.

The additional revenue initiative staffing we received in FY 1983 has been successful in reducing active delinquent account inventories and slowing the rate of growth in the amount of active delinquent accounts outstanding. The following chart highlights these improvements.

Active Taxpayer Delinquent Account Inventory

FY	Dollar Value ($ in billions)	% change	Number of Accounts (in thousands)	% change
1981	$4,679	+29%	1,436	+19%
1982	$6,717	+44%	1,967	+37%
1983	$7,708	+15%	1,997	+2%
1984	$8,512	+10%	1,934	-3%

Senator ABDNOR: What amount of IRS' resources were allocated to collecting delinquent taxes in the fiscal years 1982, 1983 and 1984? How does this figure compare to the amount of resources allocated to collecting delinquent taxes in FY 85 and FY 86?

Mr. EGGER: From FY 1982 through FY 1984, approximately 21% of IRS resources were devoted to collecting delinquent taxes. For FY 1985 and 1986 19% of IRS resources will be devoted to collecting delinquent taxes.

Senator ABDNOR: The amount of outstanding tax delinquencies are still extremely high. Does IRS anticipate reducing this amount substantially in the coming year? Does IRS have any specific goals for reducing these delinquencies?

Mr. EGGER: We do have specific goals for revenue collections. In FY 1985, we expect to collect $16.8 billion, an increase of $360 million from FY 1984. We are projecting that the amount of outstanding tax delinquencies will continue to increase, due mainly to increased delinquency notices brought about by the growth in return filing and the increases in wages and social security taxes. We are continually exploring ways of increasing our effectiveness in processing notices and collecting delinquent accounts and have placed increased emphasis on revenue collection in our overall program. In February 1985 we implemented changes to our notice processing that should encourage earlier payment. We also expect increased collections as we gain more experience under our Automated Collection System (ACS).

Senator ABDNOR: What amount of these outstanding tax delinquencies, if any cannot be collected?

Mr. EGGER: In FY 1984, $757 million, or less than 3% of total delinquencies went uncollectible because the statutory period for collection expired.

Senator ABDNOR: What does IRS view as the major road block to reducing the amount of outstanding tax delinquencies? What can be done to overcome these road blocks?

Mr. EGGER: As previously indicated, a significant portion of delinquent taxes is in notice inventory and system monitored (bankruptcy, etc.) status, areas where it is difficult to effect significant reductions. Some of the increase in notice inventory is attributable to our continuing compliance efforts directed toward increasing the universe of filers which can be monitored systemically. For example, in FY 1984 we assessed $6 billion in taxes up almost $1 billion from the prior year, Also, we have revised our notice processing and the wording of the notices in order to influence quicker payment.

The category of delinquent taxes which can be most impacted by Collection staffing is Active Taxpayer Delinquent Accounts (TDAs).

In the last two years we have continued to improve revenue collections, collecting $2 billion more in FY 84 than FY 82. Additionally we have reversed the significant account inventory increases we had experienced in the late 1970s and early 1980s. For FY 1983 our inventory leveled, and we actually realized a 3% inventory reduction in FY 1984. The dollar value growth of the inventory also slowed from 30% in the early 1980s to less than 10% in FY 1984.

In FY 1986, we will implement a Workload Priority Selection System (WPSS). This system will identify and prioritize by types and classses of tax, taxpayers who have the highest probability of being delinquent or whose delinquent account has the highest probability of being collected. This will allow us to direct our staffing to those cases which will most likely generate a delinquent return or a collected account therefore increasing our effectiveness in collecting revenue.

Senator ABDNOR: In addition to increased staffing, IRS mentioned at last year's appropriation hearings that automating the collection process was a primary initiative to improve collection operations and to accelerate the collection of unpaid taxes. In this regard, the Automated Collection System (ACS) was to be implemented nationwide in fiscal year 1984 along with the automation of other collection activities which automated much of IRS' office collections activities.

Was the ACS program fully implemented in fiscal year 1984? If not, what problems were encountered and when do you anticipate full implementation?

Mr. EGGER: I am very proud to say that ACS was successfully implemented nationwide in FY 1984, with the final phase being completed on June 18, 1984, approximately three weeks ahead of schedule.

Senator ABDNOR: What cost savings and increased collection results have you experienced from the ACS project? How does the collection of delinquent taxes under ACS compare to office functions collections prior to ACS?

Mr. EGGER: We are extremely pleased with the operation of ACS. In addition to an annual savings of 1700 staff years reduced in prior budgets (865 FY 84, 842 FY 85), ACS has exceeded the performance level of the Collection Office function (COf) which it replaced. Since all ACS call-sites were not operational for the full fiscal year, comparisons with the former Collection Office function are difficult. However, a comparison of the four pilot sites that were operational for the entire fiscal year to the prior performance of the related COf's provides a perspective of ACS' actual benefits and an indication of the potential capabilities of the system.

During FY 84, the four pilots collected $328 million from delinquent accounts compared to $277 million collected by the related COf's during FY82. This 18.4% increase in dollars collected was accomplished with 44.5% fewer staff years.

Senator ABDNOR: What is the current status of IRS efforts to automate Collection Field and Special Procedures functions?

Mr. EGGER: We are actively pursuing additional automation projects to further improve our collection process. In FY 1985, we will automate our Special Procedures function (SPf) and national office staff to streamline paper intensive operations, improve work procedures, and improve management information. We will also continue to test several automation processes in our Collection Field functions (CFf) and should complete the initial plans for nationwide automation of CFf.

We should begin implementation of the nationwide automated CFf system in FY 1986. This system will be used by our field revenue officers to access case files, make complex computations, schedule follow-up actions, and provide improved management information. Ultimately, we expect to unite the ACS, SPf, and CFf Systems into an Integrated Collection System which will permit instant access to all data on a delinquent taxpayer. This effort will complete state-of-the-art automation of Collection operations and result in additional productivity improvements.

Senator ABDNOR: Does IRS have any estimates of potential savings or increased collections from automating some of the Collection Field and Special Procedure functions? If so, please explain how these estimates were developed.

Mr. EGGER: Based on task analyses performed in our Special Procedures function and Collection Field function and determination of those tasks conducive to automation, we have developed estimates of savings expected from automating these functions. We do not expect the Special Procedures function automation to give us immediate staff savings. SPf automation will permit us to handle increased workload without increased staffing, resulting in over $5 million in savings annually.

Our preliminary estimates for CFf automation savings are 206 staffyears beginning in FY 1986. We have reduced our staffing in the FY 1986 budget to reflect this estimated savings. By the end of FY 1986 we will complete our CFf automation plans at which time we will be able to identify any further savings or increased collections resulting from automation.

Senator ABDNOR: Collecting delinquent taxes by levying taxpayer property is an important part of IRS' collection program. IRS estimates that about 50 percent of the cases closed by ACS are a result of levies. The use of levies has increased substantially in the past few years. IRS used its levy powers almost 1.4 million times in fiscal year 1983, an increase of 40 percent over fiscal year 1982. Many of the alleged taxpayer complaints over the years have involved IRS' levy powers.

How many times did IRS use its levy power in fiscal year 1984?

Mr. EGGER: In FY 1984, the IRS issued 1,484,000 notices of levy, an increase of less than 7% over FY 1983 issuances of 1,391,000.

Senator ABDNOR: How many of these levies successfully resulted in the collection of delinquent taxes? How much money was collected in fiscal year 1984 as a result of levies?

Mr. EGGER: We do not have specific data which indicates the percentage of notices of levy served which result in collection of delinquent taxes or how much money is collected as a result of issuing notices of levy. However, we do know that the notice of levy is a major tool in collection of delinquent taxes, and is often times the only means we have of securing payment.

Senator ABDNOR: How many levies were made on the wrong taxpayer's property or against taxpayers who had already paid their taxes? What are IRS' procedures when inappropriate levies are made?

Mr. EGGER: The Service takes every effort possible to ensure that its levy powers are used appropriately. Prior to levy, the IRS sends as many as four notices (five notices on individual income tax accounts beginning February 1985) to the taxpayer requesting payment. The last two notices specifically advise the taxpayer of the Service's intention to levy if our request for payment is ignored. In cases of levy on salary or wages, the last notice must be given to the taxpayer in person, left at the dwelling or usual place of business of the taxpayer, or sent by certified or registered mail to the taxpayers last known address, no later than 10 days before the notice of levy action. We research the taxpayer's account prior to levy to ensure that the notice of levy accurately reflects the balance due.

There are occasions, however, when, a levy may be issued in error. When we become aware that a notice of levy has been inappropriately issued, we release the levy and send both the taxpayer and the recipient of the levy a copy of the release and a letter of apology. If we become aware that an inappropriate

notice of levy has resulted in excessive collection, we take immediate steps to initiate a manual refund to the taxpayer.

We know that the number of taxpayer complaints are relatively small considering that we issued almost 1.5 million levies in FY 1984. I believe the safeguards outlined above provide taxpayers adequate protection and help us ensure that our levy action is appropriate in the majority of cases.

Senator ABDNOR: Since levies represent almost 50 percent of ACS case closures, what specific safeguards are built into ACS to assure that the levy powers are not abused?

Mr. EGGER: Prior to ACS working an account, the taxpayer receives up to five notices as described above, which request voluntary payment and advise the taxpayer of levy action if they ignore the notices.

The ACS computer system analyzes new accounts to verify that a final notice has been issued on all delinquent tax periods, and that mail has not been returned undeliverable. If a final notice has not been issued, ACS generates one and assigns the case for levy determination 25 days later if it still is unresolved. The analysis for undelivered mail codes was added recently because we were concerned about levying where taxpayers may not have received the final notice. We take additional actions to locate these taxpayers prior to levy action.

Our procedures for ACS call site levy requests ensure against inappropriate levy use. For example, when the taxpayer promises payment, we set a follow-up to consider a levy twelve days after the promised payment date. This allows time for a payment to be submitted late, yet be processed before the follow-up. Before levying on the follow-up date, employees research the computer system for payments. We specialize levy actions into one call site unit for better control and to reduce the chance of error.

In conclusion, we believe that our ACS design, both systemic and procedural, provides additional taxpayer safeguards.

Senator ABDNOR: Some types of delinquent taxpayers are causing IRS more collection problems than others. During last year's appropriation hearings, IRS stated that small businesses not paying their employment taxes was its main delinquency problem. In addition, GAO reported (GAO/GGD-82-4), in November 1981 that delinquencies resulting from examination were more likely to go uncollected than other delinquencies.

Is non-payment of employment taxes still IRS' main delinquency problem? How much of the total outstanding tax delinquencies are delinquent employment taxes?

Mr. EGGER: We still consider non-payment of employment taxes our main delinquency problem. It causes the Government a double loss in that income taxes withheld are not paid over yet the employees receive credit for those amounts when they file their tax returns.

Of the $29.4 billion in delinquent taxes outstanding at the end of FY 1984, well over half, $16.5 billion, are business taxes which includes employment taxes, and other business taxes such as corporate income taxes and excise taxes. A significant portion of the $16.5 billion is employment tax.

Senator ABDNOR: What is the status of the cross functional task force, mentioned during last year's appropriation hearings, that was assembled to perform a strategic review of employment tax compliance?

Mr. EGGER: The Internal Revenue Service Strategic Plan, issued in May 1984, includes 15 strategic initiatives on Strengthening Voluntary Compliance (SVC). SVC-1 established a research initiative to determine the extent and cause of non-compliance with Internal Revenue Code employment tax requirements provisions. A multifunctional task force has been assembled to develop a servicewide plan to approach employment tax problems in a unified and systemic manner. The task force is in the initial phase of its study and has developed a prospectus. Completion of the study is expected in 1988. Among other things, the group is studying withholding procedures in foreign countries to determine if any can be integrated into our system.

Senator ABDNOR: Regarding exam originated delinquencies, what action has IRS taken since the GAO study to improve coordination between its Examination and Collection Divisions? What are the ultimate collection results of examination cases?

Mr. EGGER: The Collection and Examination functions are constantly in close coordination on any number of programs to ensure effective administration of the tax laws. We now have management information reports that specifically track delinquencies resulting from examinations. Collection and Examination personnel analyze these reports and take appropriate actions to ensure early resolutions of such delinquencies. Currently 95% of the delinquencies assessed by Examination are ultimately collected.

Senator ABDNOR: Do taxpayer groups, such as tax protestors or taxpayers using abusive tax shelters, present additional collection problems? If so, what type of collection problems do they present and what specific IRS programs and procedures have been established to deal with these problems?

Mr. EGGER: The collection problems presented by the illegal tax protestors (ITPs) disrupt effective tax adminstration and cause a major danger to our voluntary compliance system. Of major concern to us in this area, as well as Servicewide, is the violent nature of these taxpayers. Collection has experienced significant increases in assaults, threats, and harassments in recent years. By using certain tax schemes, they are very effective in temporarily concealing their assets, making our investigative efforts very time consuming.

The steps Collection has taken to deal with the growing problem of illegal tax protesters is illustrative of what we have done Servicewide:

- prompt identification of ITPs;

- increased training of Collection personnel;

- development of special procedures to ensure safe, appropriate handling of ITP cases; and,

- Management information system that allows us to analyze trends so we can effectively deal with new schemes and techniques.

Senator ABDNOR: On June 20, 1983, GAO issued a report (GAO/GGD-83-47) which recommended that IRS modify its ACS to assure that bankrupt taxpayers will not receive collection notices which would violate the Bankruptcy Code's stay on collection actions. Has IRS made the necessary changes to the ACS system? If not, when will these changes be made?

Mr. EGGER: The changes recommended by GAO to the notice process have been made. These notices had been sent in error by our service centers, they were not cases that were handled by ACS.

Senator ABDNOR: Prior to August 1983, the Bankruptcy court rules required that IRS be notified of all bankruptcies files. Currently, IRS is not notified of Chapter 7 liquidation bankruptcies if IRS is not listed as a creditor. This change was requested by IRS as a cost savings measure since it would relieve IRS of processing the paperwork and researching cases that had no tax delinquencies.

Has IRS been able to quantify any savings from this change in the Bankruptcy Court rules? If so, what savings can be attributed to this change?

Mr. EGGER: Bankruptcy Rule 2002 which deleted the requirement of notice to the Service in "no tax due" bankruptcies, decreased the Service's receipts in this area by about 111,000 in FY 84. We estimate that this saved about 33 staff years. In FY 83 we received notification of 363,875 bankruptcy cases and filed 73,812 claims. In FY 84, the first full year under the Bankruptcy Court Rule, we received notification of 212,864 cases and filed 72,548 claims. As you can see, we are receiving substantially fewer cases and filing approximately the same number claims at a substantial savings.

Senator ABDNOR: What consideration has IRS given to the possibility that bankrupt taxpayers owing taxes may not list IRS as a creditor? What procedures does IRS have to assure that claims will be filed if taxpayers owing taxes fail to list IRS as a creditor?

Mr. EGGER: The bankruptcy rules require taxpayer to include delinquent taxes in their outstanding debts and there is no incentive for a taxpayer to avoid listing the IRS as a creditor because almost all taxes are nondischargeable and can be collected directly from the taxpayer after the bankruptcy case is over. It is obviously in the taxpayer's best interest to ensure

that the IRS receives as much as possible from the bankruptcy proceeding.

Senator ABDNOR: The Internal Revenue code gives IRS six years from the date of assessment to collect delinquent taxes. After the statute of limitations expires, IRS has no legal recourse to collect these delinquencies. During fiscal year 1982, over $500 million was written off because the statute of limitations expired.

What amount of delinquent taxes were written off in fiscal years 1983 and 1984 due to expiration of the statute of limitations?

Mr. EGGER: The statue expiration dollar amounts for 1983 and 1984 were not tracked by fiscal year. during calendar year 1983, $595 million was written off due to statue expiration. In calendar year 1984, $757 million was written off due to statue expiration. Both amounts represent less than 3% of total delinquencies outstanding. Beginning in FY 1985, statute expiration amounts will be tracked by fiscal year.

Senator ABDNOR: What collection programs does IRS have to assure that the taxes written off are truly uncollectible? Does IRS review these accounts as they near the statute expiration date to determine collection potential?

Mr. EGGER: When an account is first determined to be uncollectible, we require mangerial review of the account and of all related documentation. In addition to this, collection has established a second level of review of cases according to specific criteria, such as dollar amount.

As a standard policy, IRS does not review all uncollectible accounts as they near the statute expiration date. We do have several systemic programs that reactivate these cases based on updated financial or locator information. Futhermore, we follow-up on accounts when there is a strong likelihood that revenue will be collected by tracking a specific action at a future date. Additionally, we do file a federal tax lien in the majority of uncollectible cases which prevents taxpayers from transferring assets prior to satisfying their tax liabilties.

Senator ABDNOR: Has IRS ever studied whether increasing the collection period would increase collections? If so what were the results of these studies?

Mr. EGGER: While a formal study is not available, we do not believe increasing the colleciton period would increase collections. As previously indicated, less than 3% of total delinquencies are written off because of statute expiration. Our review of statute expiration reports indicates that a significant portion of account on which the statute expires result from bankrupt or defunct corporation. These are amounts which could not be collected regardless of the statutory period for collection. We do subsequently recoup a portion of these taxes from the responsible officers of the corporation under the provision of the IRC 6672.

Senator ABDNOR: An important part of IRS' collection mission is to prevent tax delinquencies from occurring. IRS' prevention activities have been aimed at businesses with primary concentration on the prevention of employment tax delinquencies.

Has IRS ever attempted to determine the cause for taxpayer delinquencies? For example, does IRS know what percentage of delinquencies result from taxpayers being unaware of tax requirements?

Mr. EGGER: In FY 1982, we conducted a study to determine the causes of non-compliance. After randomly selecting delinquent taxpayers in 16 IRS districts, Collection field personal (revenue officers) interviewed these slected taxpayers to determine why they had failed to timely file and pay their taxes. Of the individual taxpayers interviewed, 61% where delinquent because they had failed to make appropriate etimated tax payments, due to cash-flow problems. The remaining individual delinquencies were largely the result of examination deficiencies or improper withholding from wages.

Of the BMF taxpayers interviewed, 76% of the delinquencies were due to failure to make appropriate deposits or other payments mainly due to unexpected loss of business income or accounts receivable problems. The other 24% were examination deficiencies (2.9%) and causes not specified, but subsequently fund to relate mainly to inappropriate deposits.

This study did not identify taxpayer lack of awareness of tax requirements as a reason for tax delinquency.

Senator ABDNOR: Does IRS have any new delinquency prevention programs for individuals? If so, how do these programs work?

MR. EGGER: We have no formal delinquency prevention programs for individuals. Rather, we now rely more on automated programs to detect noncompliance among individual taxpayers. The Service has made major improvements in its ability to match taxpayer information documents against our taxpayer Master File as a means of detecting tax delinquencies. Additionally, Collection has made major improvements in its processing of these cases and should have the ability by FY 1987 to double the number of its contacts virtually addressing all balance due cases identified from information documents. In the course of our contact with delinquent individual taxpayers, we ensure that they are aware of their tax obligations and advise them of the actions they must take to avoid future delinquencies.

Senator ABDNOR: Does IRS have any new delinquency prevention programs planned for future implementation? If so, how will these programs operate?

Mr. Egger: In addition to the improvements noted above in our delinquency preventation efforts, we are expanding our Returns Compliance Programs (RCP) to better address delinquency among self-employed taxpayers who would not be identified under information document matching programs. These RCP programs identify taxpayers not already on the master file and, as such, ensure subsequent years compliance from these taxpayers. In

addition to programs developed locally by our districts, we also develop national programs that use established third party information, e.g. contractor association listings, to identify delinquent taxpayers.

AMNESTY

Senator ABDNOR: Although IRS mentioned during last year's appropriation hearings that it did not favor implementation of an amnesty program at the federal level to deal with delinquent taxpayers, it did mention that IRS was studying the area. A complete report dealing with amnesty was expected in the fall of 1984.

Has IRS completed its study of an amnesty program? If so, what were the results?

Mr. EGGER: At the time the study was initiated, only five states had conducted tax amnesty programs so a deadline of fall 1984 seemed feasible. However, as the study progressed, more states opted for tax amnesty and so in the interest of doing as thorough an analysis as possible on the issue, the study was expanded. The study report now is expected to be available in June 1985.

COMPUTER TECHNOLOGY

Senator ABDNOR: IRS processed over 171 million tax returns and collected gross tax receipts of about $627 billion in tax revenues during fiscal year 1983. Without computers, these activities would have been virtually impossible. Accordingly, an increasing percentage of IRS' operating budget is spent for ADP support. During the last 5 years, IRS' budget for automation has grown from about $45 million to over $450 million annually.

In September 1983, GAO issued a staff study, Computer Technology at IRS: Present and Planned (GAO/GGD-83-103), which outlined and explained the ambitious and far-reaching initiatives underway and planned to increase the level of computer support throughout IRS. The GAO study stated that, given the dependence IRS has on data processing, it is critical that computer resources be managed from a Servicewide perspective to ensure that they support all of IRS' missions and objectives with maximum efficiency and effectiveness.

Long Range Planning

Since 1975, IRS has recognized the need for a long range ADP planning system and long range strategic ADP plan. During FY84 hearings, IRS testified that it was developing a strategic ADP plan to guide the approval of ADP projects. In May 1984, IRS published a strategic plan to provide the foundation for directing tax administration efforts into the 1990's and lay the groundwork for the Service's entry into the next century.

The ADP portion of the plan identified 14 specific initiatives to develop an information management strategy. According

to the plan, these 14 initiatives are intended to facilitate a transition from a centrally controlled, mainframe-based systems computer enviroment to one in which computers and information technology are pervasive. The initiatives are also intended to facilitate a shift in emphasis from functionally oriented to multifunctional systems.

How has IRS proceeded with regard to implementing the 14 strategic initiatives? What are the status and overall goal of the initiatives?

Mr. EGGER: After I approved the Information Management Strategy initiatives in the IRS Strategic Plan, oversight responsibility for each initiative was assigned to an IRS executive. These executives developed individual implementation plans, which were then submitted for my approval. All of the IMS implementation plans were approved between August and October 1984. The timetables for completing implementation vary according to the scope of each initiative and range from mid-1985 to 1990. Progress reports are made on a regular basis.

The overall goal of the IMS initiatives, in addition to that related in the question, is to establish a comprehensive system that will make needed information readily accessible to those who are involved in tax administration efforts. The goal reflects it from a Servicewide, rather than strictly functional perspective. The initiatives provide the directional framework for the various operational plans that will be developed to adapt to advances in information systems technology.

Senator ABDNOR: What organizational and system changes does IRS forsee as the strategic initiatives are implemented?

Mr. EGGER: The assumption that some organizational and systems changes will accompany implementation of the strategic initiatives was factored into the Strategic Plan. A number of initiatives specifically address this issue, particularly in the IMS segment of the Plan. Studies are being conducted by IRS with assistance from outside consultants concerning what changes might be needed and how and when they should be introduced. It is premature to predict just how the organization or current systems will be affected by any of the strategic initiatives, even the broad-scope major projects such as Tax System Redesign. We will have better indications as the implementation plans on the initiatives evolve over the next year.

Senator ABDNOR: How do broad-scoped major projects fit into these initiatives especially those that will take a number of years to develop, such as the Tax System Redesign Project and the Decision Enhancing Management Information System?

Mr. EGGER: The Service's Information Management Strategy (IMS) Initiatives address organizational and policy issues and thereby set the context for operational plans. They are intended to provide a generalized and flexible infrastructure which promotes effective management of specific systems development efforts as well as major projects. The inclusion of the Tax System Redesign Project (TSR) as a separate initiative recognizes the scope and significance of that project to the Service's long term plans for information systems.

EQUIPMENT REPLACEMENT PROGRAM

Senator ABDNOR: During 1979, IRS initiated a program to modernize the computer hardware that supports the tax system. The program, called the Equipment Replacement Program, involved three projects: (1) replacing the main computers in IRS' 10 Service Centers, (2) redesigning the accounts research system which was then supported by microfilm files, and (3) modernizing the National Computer Center computers which supported master file processing. All three projects were to be completed in about 8 years beginning with FY 1980 and ending during FY 1987. These projects are supposed to provide IRS the ADP capacity and capability it will need into the 1990's.

During FY 1984 hearings before the Senate Committee on Appropriations, IRS provided a table showing that the Equipment Replacement Program would cost about $180 million to implement from FY 1980 through FY 1987. About $49 million or about 28 percent of the total cost was allocated to personnel costs.

Is the program on schedule and, if not, what are the revised estimates for completing the program?

Mr. EGGER: The Equipment Replacement Program (ERP) has been completed on schedule. The Service Center Replacement System (SCRS) was installed in the 10 Service Centers in accordance with the original 1979 schedule. In the case of the Microfilm Replacement System (MRS) and the Master File Replacement System (MFRS), installation occurred ahead of schedule.

Senator ABDNOR: Have the projected costs changed and if so, what are the new cost estimates? What are the total costs for each of the three projects?

Mr. EGGER: The actual equipment acquisition costs through FY 1985 and the projected equipment costs for FY 1986 and FY 1987 are identified in the following table:

ADP Equipment (Amounts in Million of Dollars)

	FY80	FY81	FY82	FY83	FY84	FY85	FY86	FY87	TOTAL
SCRS	0	0	2.5	12.5	20.0	33.3	36.2	26.5	131.1
MRS	0	0	.7	1.7	1.7	1.7	1.7	1.7	9.0
MFRS	0	0	0	1.7	1.8	2.5	.7	.8	7.1
TOTAL	0	0	3.2	15.8	23.5	37.2	38.6	29.0	147.2

In the case of SCRS, the original contract estimates in 1981 were $103.5 million.

Senator ABDNOR: If there have been schedule or cost changes, why have they occurred?

Mr. EGGER: In the case of SCRS, costs have exceeded estimates because equipment had to be added much sooner than anticipated, and some equipment that was not anticipated at all had to be added. Workload estimates were based on conservative growth rates in document processing and no growth in the applications that are performed by the SCRS equipment. These estimates were found to be somewhat low.

More significantly, IRS underestimated the capacity required to process with a higher level language (COBOL) and a data base management system. Our estimates did not include some new applications or an allowance for programmers's lack of experience with the new system.

Equipment costs for MFRS and MRS are close to, or less than, the estimated costs. In the case of MFRS, the greater cost is primarily the cost incurred when an installment purchase is made (whereas the estimate was based on a purchase). In the case of MRS, telecommunications costs were less than expected.

Senator ABDNOR: Probably the most significant aspect of the Equipment Replacement program is the conversion from assembly language to COBOL of the almost 1,500 computer programs which have been used to support tax returns processing and other tax administration activities in IRS' 10 regional Service Centers. The conversion was to be carried out in four phases with the final phase scheduled for completion by January 1985. These programs will run on the Service Center Replacement (SCRS), or a Sperry Univac 1100 series computer system.

Did the estimated $49 million in personnel costs include the software conversion costs? If so, what portion of the personnel costs were attributable to the sofware conversion of the Service Center computer programs?

Mr. EGGER: The $49 million in personnel costs equated to 1,431 staff years, of which 846 staff years were for software conversion. We estimate that the total software conversion costs will be 850 staff years.

Senator ABDNOR: Was the conversion completed on schedule and, if not, what are the revised completion dates for the conversion phases?

Mr. EGGER: The conversion was substantially completed on time. The four phases incorporated into a Service Center Replacement System (SCRS) Transition Plan were subject to revisions as time and conditions necessitated changes. Furthermore, each of the four phases was subdivided into separate projects, often with distinct and differing dates. Nevertheless, by January 1985, about 98% of the entire SCRS conversion had been completed. The final series of new computer programs are scheduled for

implementation during the last quarter of Fiscal Year 1985.

Senator ABDNOR: Have all of the converted programs been subjected to systems acceptability testing? If so, what is the status of the testing?

Mr. EGGER: All major SCRS Systems have been Systems Acceptability Tested (SAT) within the time frames available. Subsystems which represent 1% to 2% of the total package are now in SAT or have yet to be transmitted to SAT.

Senator ABDNOR: Are the converted programs satisfying their processing requirements? If so, how have you determined that system users are satisfied with the converted applications?

Mr. EGGER: Generally, the converted programs are satisfying their processing requirements. The data being generated by the converted programs is in accordance with the specifications provided. However, user satisfaction is not as high as we would like due to delays in receiving output and inability to access information timely. Because of the magnitude of the conversion effort, we have supplemented our normal problem reporting mechanism with: special field visits by our National Office managers and technicians, frequent discussions amoung IRS managers of different functional areas, field and National Office conferences, and special conference calls between National Office and field officials. These processes have been useful in not only assessing user satisfaction but also have helped resolve operational problems.

Senator ABDNOR: After the SCRS contract was awarded, each of the 10 regional Service Centers received a Sperry Univac 1100/82 computer system. The lease/purchase contract provides for ADP equipment and maintenance over an 8-year period, as well as a provision for expanding the systems to handle work load growth. The 1100/82 system with its two central processing units (CPU) can be expanded to an 1100/84 system with four CPUs. The expandability of the system was intended to provide sufficient computer capacity through the late 1980s. We understand, however, the IRS has become concerned about capacity limitations on the systems and has already acquired the third and fourth CPUs several years ahead of schedule. Apparently IRS' capacity concerns stem from (1) an inappropriate sizing technique and nonstandard software used by Sperry Univac during system benchmarking; (2) the additional computing capacity required by the computer programs which have been converted to the high level language, COBOL; (3) requirements for new applications such as an on-line error corrections system that were not included in the system sizing process; and, (4) the decision to make the real time operations of the system available 16 hours per day rather than 12 hours a day which was used in the benchmarking process.

To what extent do each of these four factors account for the capacity limitations? To what extent should the benchmarking process have minimized the problem?

Mr. EGGER: It is not possible to accurately quantify each factor's effect on capacity. The following general statements can be made:

(1) Sperry's sizing of the proposed system left no excess capacity over and above that required to minimally pass the benchmark. The result was that any deviation between benchmark and reality immediately required additional power.

The benchmark process itself was valid and sufficiently accurate to achieve its intended purpose of sizing a rollover system with minimal growth. That is, it reflected then-current applications converted to COBOL, use of the vendor's proposed data management software, and workload projections based on existing/approved applications and conservative growth. One should remember that the benchmark was designed in 1979 by approximately ten technicians. They attempted to simulate in 1979 what we thought our processing reality would be in 1985.

(2) Additional COBOL overhead was accounted for in the benchmark since IRS applications were written in structured COBOL. However, when programs were actually converted, the learning curve necessary to efficiently use COBOL on a new system in a data base environment contributed to loss of efficiency/capacity. A large portion of this loss has already been recovered through optimization efforts implemented last fall, with more to be gained through continued optimization/education initiatives.

(3) Even though the SCRS was sized for and approved to be a direct replacement for, or rollover of previous processors, the need for additional automation has resulted in numerous new applications requiring significant processing being added to the system. For example, the On-Line Error Resolution System real time processing requires approximately 18% of an 1100/84 system.

(4) Increased real time availability will affect the time frame/resources available to process batch work. The commitment to 16 hour daily real time processing was made after SCRS sizing and has had a net negative effect on batch processing.

Senator ABDNOR: We understand that IRS has initiated a procurement for five additional Sperry Univac 1100/82 computer systems for your four highest volume Service Centers. This action is intended to resolve short term capacity problems.

Under what terms and conditions were these additional systems purchased?

Mr. EGGER: The five additional Sperry 1100/82 computer systems were acquired for Atlanta, Austin, Fresno, and Ogden Service Centers, and the National Computer Center by issuing a contract modification against the existing Service Center Replacement System (SCRS) contract. The modification, number twenty-six (26) to contract TIR 81-51, was signed on July 26, 1984, and was issued under the authority of Section E, Paragraph E.3.2, Option to Vary Quantity.

Senator ABDNOR: Are these systems helping resolve IRS' capacity problems? If so, how?

Mr. EGGER: The acquisition of the additional Sperry 1100/82 systems has provided some relief to these high volume Service Centers that are experiencing capacity problems. These additional systems are being used for weekend processing, and batch processing during the week, which was formerly completed entirely on the Sperry 1100/84 system.

Senator ABDNOR: We also understand that IRS is planning to replace all of the Sperry Univac 1100 systems sometime during 1987. This replacement action will take place many years ahead of schedule.

Will this procurement be a sole source or limited competition procurement?

Mr. EGGER: There will be a sole source procurement during FY 1986 and FY 1987 to upgrade the Sperry Univac 1100 main processors to meet immediate processing capacity shortages through 1987. This will be followed by some type of procurement action to upgrade or replace the 1100 systems to meet IRS processing needs beyond 1987. There will also be a competitive procurement for additional compatible disk storage equipment to meet IRS growth needs.

Senator ABDNOR: What are the cost estimates for the replacement system? Do cost estimates include software conversion costs?

Mr. EGGER: No decisions have been made on the replacement system with regards to either procurement methodology (sole source, limited, or fully competitive) or equipment configurations. Therefore, no specific cost estimates are available at this time. Software conversion costs will be dependent upon vendor selection.

Senator ABDNOR: If the procurement is to be a sole source procurement, what assurances does IRS have from the hardware vendor that the proposed replacement system is technically proven and capable of handling IRS' processing work load?

Mr. EGGER: IRS conducts very few procurements (whether sole source or not) without either performance

specifications and/or an actual performance test. In the event that our sole source procurement involves new configurations for which we have no performance data, IRS will require a pre-contract award test. Also, there will be post-award tests at the National Computer Center (NCC).

DISTRIBUTED INPUT SYSTEM

Senator ABDNOR: Besides the Sperry Univac 1100 systems, IRS service centers have received a new data entry and transcription system called the Distributed Input System (DIS). During 1983, IRS decided to move the on-line Error Resolution System (ERS) and the major returns processing programs, referred to as Generalized Mainline Framework (GMF), from the Sperry Univac 1100 onto the DIS to free up capacity on the 1100 system.

Since DIS originally was not sized and configured to process the work load of the ERS and the GMF, how is IRS making this change? Will this require a limited competition procurement of additional DIS equipment?

Mr. EGGER: The Error Resolution System (ERS) remains on the Sperry Univac 1100 System and will not be moved to the Distributed Input System (DIS), but will be part of the Real time Input System (RIS) as described in the answer to the next question. A portion of the Generalized Mainline Framework (GMF) was moved to the DIS. Approximately 60% of one GMF processing run, GMF01, was moved to the DIS. The additional ADP equipment resource needed to process the DIS portion of GMF was provided by upgrading the DIS National Advanced Systems (NAS) AS/6620 processor at each of the ten Service Centers and the National Computer Center (NCC) to NAS Model AS/6650's. This was accomplished by negotiating with the DIS contractor (Four-Phase Systems, Inc.), on a GSA approved, sole source basis to modify the DIS Contract, TIR-83-085. The contract modification was to incorporate contract line items for the AS/6650 and processor memory upgrades.

Senator ABDNOR: Will this project eventually lead to two major computer systems operating in the service centers? Was consolidating service center computer processing on one system a primary goal of the Equipment Replacement Program? If so, is this goal still desirable?

Mr. EGGER: The current plans are that by mid-1987 IRS will utilize only two major computer systems for Service Center mainline tax processing. These two systems will be the Real time Input System (RIS), an outgrowth of the DIS, and an upgrade of the Sperry Univac 1100 Systems.

One phase of the Equipment Replacement Program (ERP) was to replace, in each Service Center, IRS's Honeywell 2050A systems, used for mainline tax processing, and the Control Data Corporation (CDC) Model 3500's, used for IRS's Integrated Data Retrieval System (IDRS). The goal

was to consolidate the mainline workload of the Honeywell 2050A and the workload of the CDC 3500 onto a single system. The data entry and transcription system used by the IRS at that time, the Direct Data Entry System (DDES), was not part of the replacement plans. The DIS was the initiative to replace the DDES. IRS does not have a goal of a single computer system for mainline tax processing. We do, however, desire systems which are properly integrated, highly compatible, and sufficiently flexible to deal with the changes of tax planning.

Senator ABDNOR: To improve returns processing efficiency and responsiveness to the public, we understand IRS has initiated a development project called the Real-time Input System (RIS). The project's objective is to integrate, within a single system, logically associated returns processing functions that are currently divided between the DIS and SCRS. The RIS concept, as approved by the Automation Policy Board in August 1983, involves the redesign and integration of DIS, the GMF, the Error Resolution system, and the Service Center Control File.

We also understand IRS' plans for RIS propose acquiring 11 IBM-compatible CPU's and necessary peripherals to replace the DIS master node, AS/6650's at the NCC and the 10 service centers. According to IRS' preliminary analysis, if non-IBM compatible CPUs are procured, some vendor proprietary software modifications will be necessary. This would introduce some risk of disrupting ongoing returns processing. The plan is to award a contract to the successful vendor under a 48 month Lease-To-Ownership-Plan. As of September 1984, an RFP was to be issued in January 1985 and a contract award was to be made by November 1985.

What is the development status of the Real-time Input System?

Mr. EGGER: The system concepts were presented and approved in April 1984. The Service has adopted a Software Development Life Cycle (SDLC) methodology consisting of specific phases and stages of software development. At this time, the Functional Specifications Package (FSP) has been published and distributed for review. Walk throughs for the detailed design phase are now underway. These milestones are approximately three months later than the projected completion dates.

Senator ABDNOR: What are the project's milestones and estimated costs?

Mr. EGGER: Key RIS milestones, as presented in the IRS' Information Systems Initiative Summary - Real time Input System, are:

- Requirements Analysis	09/84
- DPA Granted	11/84
- Issue RFP	01/85
- Contract Award	10/85
- Initial Installation	01/86
- System Operational Nationwide	01/87

The DPA and RFP issuance dates were not met due to delays in getting the DPA from GSA. Also, a review of the overall schedule may cause other milestone changes.

The total systems life costs for RIS, including carry over cost of DIS for 1987-1992 is $115,450,000.

Senator ABDNOR: What assumptions were used and what steps were taken or are being planned to ensure that system capacity requirements are sufficient?

Mr. EGGER: The processor sizing for the RIS consists of identifying processor requirements in terms of Central Processing Unit (CPU) hours, for the DIS data entry and transcription and the Sperry Univac GMF and ERS workload. These combined requirements were then apportioned over a five day work week (Monday-Friday) assuming three, eight-hour production shifts daily. The first and second daily shifts were assumed to be equal in workload, with the third shift workload being somewhat less. The resulting CPU hours needed during a single day were used to determine a processor performance range necessary to process the projected RIS workload. System peripheral needs were developed based on anticipated workload volume and general system requirements.

To assure that system capacity is adequate, a Performance Demonstration (PD) of all technically responsive system offerings will be conducted. Proposed offerings must provide adequate processor resources to meet projected IRS needs for the full six year systems life. Also, the RIS contract will include language to ensure that unanticipated future processor resource needs can be acquired.

Senator ABDNOR: Are quality assurance activities being given appropriate emphasis and management attention during IRS' software developments?

Mr. EGGER: The Quality Assurance Section of the ADP Standards Branch within IRS reviews all documentation on the Real time Input System (RIS). In addition, walk-throughs are performed to review each development phase, a detailed test plan is developed, programmer testing is performed, a Systems Acceptability Testing (SAT) is held, and a 6-month pilot test of the system precedes nationwide implementation.

Senator ABDNOR: How does IRS plan to evaluate and validate vendor proposals?

Mr. EGGER: Each proposal received will be evaluated by a separate technical team. Each technical team will determine whether the proposal being evaluated addresses and meets all stated requirements of the Request for Proposals (RFP). Any discrepancies, inconsistencies or failures to meet requirements will be identified. Required communications to the vendor will be conducted in an attempt to resolve the issue(s) in question.

Requirements of the RFP which require a degree of subjective evaluation will be evaluated by a single subjective team. This team will have access to all proposals received.

Proposals meeting all requirements of the RFP will have the systems proposed subjected to a pre-contract award Performance Demonstration (PD). The PD is designed to validate that the system proposed meets both the initial and out year needs for the systems life of the RIS. The vendors are required by the RFP to propose systems upgrades to meet future year system needs for the systems life. The PD can be run by the IRS at any time during the RIS systems life to verify the adequacy of the systems or upgrades proposed. The initial PD will be conducted at each vendor's site by a PD team. This team will consist of a "core" group of hardware and software specialists and IRS management. Also represented will be the technical team for that vendor's proposal, the subjective team, and a Contracting representative.

Senator ABDNOR: How will or could the capabilities of the planned RIS support the requirements of the Tax System Redesign Project?

Mr. EGGER: At this stage of the Tax System Redesign Project (TSR) it is difficult to say with certainty that the RIS would be a key component. However, at the time TSR is scheduled to begin implementation, the RIS equipment and capabilities could be utilized by TSR.

INTEGRATED DATA RETRIEVAL SYSTEM AND TERMINAL AND COMMUNICATIONS SYSTEM REPLACEMENT PLANS

Senator ABDNOR: IRS developed its Integrated Data Retrieval System (IDRS) to provide instantaneous visual access to up-to-date taxpayer account information. Used primarily as a real-time data retrieval/account update system, IDRS originally consists of a Control Data Corporation (CDC) 3500 computer system, peripheral tape and disk subsystems, a Sperry Univac 9040 Data Communications Processing System (DCPS), and CDC terminals.

All components of IDRS are currently being replaced or will soon be replaced. The CDC 3500 and its peripheral subsystems are being replaced by the SCRS Sperry Univac 1100/84 systems and its associated peripheral tape and disk subsystems. The IDRS terminals and the

Sperry Univac 9040 DCPS are being replaced by separate procurements. This project, which is being accomplished in two phases, is expected to cost over $100 million. Phase I involved buying up to 4,000 terminals from Sperry Univac, Inc. Phase II will include buying up to 5,000 additional terminals, new data communications processing systems, a printing capability for the terminals, and equipment for fully automating the master file transcript request process.

IRS plans to use the communications replacement system to support and interface several systems. The Request for Proposals (RFP) requires the data communication processing system to be able to interface with the Sperry Univac Computer Systems; the Distributed Input System; and the Automated Collection System, another IBM piece of equipment; and the Zilog minicomputers.

The RFP is also requiring the winning vendor to provide a security system. Currently, IRS officials do not believe any of the potential vendors have an off-the-shelf security system that will satisfy IRS' requirements. As a result, vendors may need additional time to develop security software.

We understand that IRS has several concerns regarding the IDRS procurements. These concerns are: (a) meeting the current implementation schedule; (b) vendor responsiveness in developing security software; and, (c) the possibility that IRS could switch the current Sperry Univac equipment after 1986.

Are the Phase I terminals satisfying user requirements?

Mr. EGGER: The Phase I IDRS terminals are satisfying user requirements with some reservations. The integration of a massive number of terminals into the IDRS Service Center networks have introduced some slow response times and temporary outages. It appears we have isolated and resolved most problems and that the terminals are now meeting all user requirements.

Senator ABDNOR: Does IRS have specific plans to convert existing software applications to take advantage of the larger terminal screens and to improve data communications system throughput?

Mr. EGGER: The Phase I terminals as well as the Phase II terminals will have the capability of utilizing both "small" screens (512 characters per transaction) and "large" screens (1920 characters per transaction). The Service currently has approximately 200 application programs which, as part of the program, dictate whether the transaction is large or small. Most of these application programs are presently small screen. As various application programs are changed either because of an application program redesign or a change in the tax law, the rewrite

will include adapting the programs to take advantage of the larger transaction size. Rather than a total rewrite effort, the Service will rewrite the programs as programmers become available with the emphasis on programs which have larger data transmission requirements.

Senator ABDNOR: What does IRS plan to do with the networking capability being requested in the RFP? Are IRS' plans tied to an overall telecommunications plan?

Mr. EGGER: Based on our past experience we feel the Service must have the capability to grow with new requirements. The original IDRS was very limited with respect to growth. The Service reached a point where no new applications could be considered because of equipment and network limitations. The Communication Replacement System (CRS) included in Phase II has growth requirements which can provide the Service with the ability to respond to growth requirements which may be unforeseen at the time of initial installation. This growth capability has been estimated in the Request for Proposals, and has been specified as optional equipment which could be procured if needed. Our experience with various taxpayer service, examination and collection requirements indicate that the options we have specified in the request for proposals will be exercised by the Government at the times specified, if not earlier. The effect of increased networking capabilities will afford the Service the ability to respond to and meet the needs of both the taxpayer and the Government.

The Service's plans as they relate to the Integrated Data Retrieval system are not tied to an overall telecommunications plan. The Service at this time does not intend to install a nationwide IDRS network. We intend to remain with the ten separate Service Center networks. A requirement of the Phase II RFP is the connection of the Service Center communications processors with the communications processor at the National Computer Center in Martinsburg, WV. This requirement will replace a slow manually initiated tape to tape transmission system, which is currently used by the Service for transcript research.

SENATOR ABDNOR: How responsive was industry to the Phase II RFP? How has IRS ensured that the terminals and communications replacement system will meet their processing requirements?

MR. EGGER: The Service is in the final stages of the technical evaluations for the Phase II Request for Proposals. The Service feels the response from industry has been excellent, and the Government has received several proposals which meet the requirements of the Request for Proposals. Since this is still an active procurement effort the number of responses, the vendors making those responses, and the reasons for the nonresponsive proposals has not been included in this discussion.

The Service feels confident the vendors still under consideration meet the procesing requirements specified in the RFP. During the technical evaluation we sent each bidder written questions which were required to be answered in writing. The Service has (or will) conduct face to face meetings with the bidders to resolve those unanswered questions which remain applicable. Additionally the Service has called for a demonstration of equipment similar to that being proposed. As part of the Contract the successful bidder will be required to pass a System Operations Capability Test prior to the installation of any system at any service center site. Failure to pass this test could be reason (and is addressed in the RFP) to cancel the contract and to seek the next best bidder.

Senator ABDNOR: How did vendors respond to the requirement for a security system? How were the responses factored into IRS' evaluation of vendor proposals?

Mr. EGGER: The Request for Proposals requires that the bidder provides security and validation software for the Communications Replacement System (CRS). Extensive detailed requirements for the functions of this software are described in the RFP. Vendors responded with certifications of their ability and intentions to comply with these requirements. The security and validation requirements were minimum technical requirements in the RFP, and not included as part of the subjective evaluation criteria. Failure of a bidder to fully meet these requirements would result in the vendor being considered non-responsive.

Senator ABDNOR: What impact would replacing the Sperry Univac 1100/84s have on the Phase II procurement? Could this significantly limit the system's life?

Mr. EGGER: The impact of replacing the Sperry Univac 1100/84 will not have an impact on the IDRS Terminal Replacement, Phase II effort. Most of the Communications Replacement Systems (CRS) proposed in meeting the requirements of the Phase II RFP could be interfaced to most host processors currently in the market place. The communication processor acts as a translator between the terminal and the host processor, therefore, the terminals could be used regardless of the host. At worst case, an interface unit might have to be designed and procured from the CRS or the replacement host contractor. The system life of the CRS and the terminals being procured in Phase II (or the terminals procured in Phase I) would not be reduced.

OPTICAL CHARACTER RECOGNITION

Senator ABDNOR: During January 1984, IRS began to optically scan both Federal Tax Deposit (FTD) forms and 1040 EZ

tax returns on the same equipment. Pilot test results for FTDs showed that although the equipment was effective in scanning the documents, through-put rates were not achieved. Subsequent testing of the system to process 1040EZs was very limited. Even so, IRS decided to implement both applications Servicewide. Several internal IRS studies have identified numerous operational problems with the system.

What are the expected through-put rates for FTD and 1040EZs and have these rates been achieved? If not, why not?

Mr. EGGER: Expected through-put rates for FTD processing were set at 65,000 per eight-hour shift. During pilot this rate was not achieved due to two major factors. The Form was not optimized for scanning and the vendor-provided software was not adequate for our needs. These issues have been addressed and the system is now capable of approximately 60,000 FTDs per shift. This is more than sufficient to meet our daily production needs.

Production rates of Forms 1040EZ processed via scanning were expected to exceed rates achieved through the conventional method. The rates for 1984 were 177.4 per hour by scanning and 101 per hour by conventional data entry.

Senator ABDNOR: What, if any, back-up measures does IRS have for processing these documents.

Mr. EGGER: Forms 1040EZ can be processed normally through Service Center Analysis Transcription if scanning is not available due to other priorties or is non-operational.

The back-up measures for FTD processing are threefold. These documents can be key entered via the data entry terminals associated with the scanner. These terminals are normally used for making corrections. During 1984 we also had the ability to enter FTDs through the system used for processing other tax returns. Because this method is very costly, we have developed a third option which is not yet available. This alternative involves the use of the Optical Readers acquired for the processing of Forms 1099, interest and dividend information documents.

Senator ABDNOR: How have the operational problems identified in the studies been resolved?

Mr. EGGER: The major problems with the FTD application during testing and initial nationwide implementation were in the area of through-put and system downtime. The first issue was nationwide and was addressed by directing the vendor to do a major system's overall early in 1984. Part of the problem stemmed from the fact that the system was weighed down with having to process a mix of old forms (punch cards) and revised forms (paper). The combination of revised software and purging of old forms corrected the problem.

System's downtime was localized in certain centers. Discussions with the vendor quickly pin-pointed the problem to

inadequate field engineer support at several sites. The vendor remedied the situation and we do not presently have a problem with excessive downtime.

Other problems we have identified are related more to how the taxpayer is completing the form. Approximately 10% of FTDs are received with incomplete data. We have addressed this issue by revising the instructions, issuing stuffer notices in forms mailouts and are also planning to individually correspond to taxpayers who are submitting forms incorrectly.

Concerning 1040EZ processing, we are not aware of any studies which identified operational problems. As problems were identified during processing, they were corrected.

Senator ABDNOR: What impact will other current or planned processing systems (e.g., DIS, RIS, TPSR) have on the use of OCR technology?

Mr. EGGER: These current or planned technologies will have no impact on OCR. However, OCR will impact on these systems in that the volumes available for these systems will be reduced. The Service is currently pursuing the feasibility of electronic filing of tax and information returns. If a system is adopted, it will reduce the usefulness of OCR since the volume of paper documents would be less.

Senator ABDNOR: Because IRS considered the optical scanning of 1040EZs a success, they converted several employer filed returns to a machine readable format. In 1983, over 25 million employment tax returns were filed at IRS. These returns represented all sizes and types of business enterprises.

To what extent has IRS considered user (i.e., taxpayer) needs in designing machine readable tax forms? For example, processing volume can be adversely affected by taxpayer confusion over correcting typing errors or failure to follow precise instructions in preparing machine readable forms.

Mr. EGGER: In developing our optically scannable tax forms, IRS has considered taxpayers needs. We have conducted tests to determine whether taxpayers react favorably to tax forms that can be optically scanned and can complete these forms accurately.

Our tests showed that most taxpayers had few problems completing these forms accurately, and in some instances, accuracy of completion improved when a scannable form was used.

We are aware, however, that the color of the print that must be used on an optically scannable form to enable the scanning equipment to "read" the form may be somewhat difficult for some taxpayers to read. We are taking steps to improve the quality of the print wherever possible. For instance, we recently revised Form 942, by printing the instructions at the bottom of the form in black ink, rather than in light brown ink that must be used on the form itself for optical scanning purposes.

We provide taxpayers with instructions to the forms explaining how to complete the machine-scannable form properly.

In some instances, we provide actual examples of how to print numbers so that the scanning equipment can read the numbers correctly. Our experience has shown that most taxpayers are able to complete these forms accurately using our instructions on how to prepare them.

Senator ABDNOR: Have the new (optical character) forms slowed processing since they require special preparation which increases the potential for taxpayer error?

Mr. EGGER: Neither Form 941 nor 942 are currently being processed with scanning equipment. The test date is scheduled for August 1985.

In converting these forms to machine readable format, no changes were made that adversely affect the taxpayer. The Form 941 was rearranged at the request of the AICPA (American Institute of Certified Public Accountants) to enhance the ease of filling out the form. The only change made to the 941 to make it machine readable was to print it in OCR drop-out ink. Taxpayers were informed that this was done in order to scan the return, and that only typed returns could be scanned. The scanning equipment can read items that have been corrected or erased and retyped. There are no other "precise instructions" that need to be followed.

As for the Form 942, the only change made to it was to convert the lines on the return to "OCR" boxes. The Form 942 can be filled-in by hand, instead of typewritten, and still be machine read. In order to read handwriting there must be more space between the lines than was possible with the Form 941. The Form 942 lent itself to this situation because there are only 6 lines of information requested on it. Again, the OCR machine can read corrected/erased figures, so there is actually no increased burden to the taxpayer, other than a request that they keep figures within the OCR boxes, use a lead pencil, and enter zeroes in the cents field if they use whole dollar amounts.

We do not believe that OCR scanning will slow the processing of these returns. It should result in an opposite situation. The scanning of returns will eliminate the human errors and hence reduce the time it takes to process them through the system.

Senator ABDNOR: Will the new format require small enterprises to purchase special equipment or services outside their normal business operations to have the forms prepared?

Mr. EGGER: No. The Service will accept and process hand-written input if machine (typewritten, word processor, etc.) input is not available.

FILES ARCHIVAL IMAGE STORAGE AND RETRIEVAL SYSTEM

Senator ABDNOR: IRS plans to address the problems of space shortages for tax returns storage and lengthy waiting time when requesting returns from Federal Record Centers through the

application of laser optical technology. To resolve these problems, IRS plans to test a new system called Files Archival Image Storage and Retrieval System (FAISR), which will incorporate a laser storage technology into the returns processing function. A laser storage technology system is to be tested at the Fresno Service Center during 1985. User acceptability and cost analysis will be studied after the test is completed to determine if the system should be expanded.

The purpose of the FAISR project is to determine if recently developed electronic technologies will be able to replace the current method of paper storage and retrieval. As envisioned, FAISR will convert tax returns to digital facsimile images and retrieve the images on high resolution terminals. Processing which requires documentation would use the return's facsimile images rather than the paper return. Hard copy prints can be made if needed.

What is the status of IRS' test plans for FAISR?

Mr. EGGER: A contract was awarded to Integrated Automation of Alameda, California on May 30, 1984, for an optical disk system to conduct a research test. The Factory Acceptance Test is scheduled for the week of June 17, 1985. The system will then be installed at the Fresno Service Center, and the System Acceptability Test will commence August 5, 1985. IRS will conduct the research test for a period of one year. Based on the evaluation of the statistical test data, IRS will decide whether to recommend the expansion of the FAISR system to all service centers. This is one of the non-paper storage techniques the Service is exploring that I alluded to before.

Senator ABDNOR: What is the relationship between FAISR and the Tax System Redesign project's plans for state-of-the-art storage technologies?

Mr. EGGER: The Tax System Redesign project's plans are long-range and based upon the concept of paperless filing of tax information. The pertinent tax data may then be stored on optical disks. The FAISR system will serve as a technological bridge between our current paper filing and storage system and the paperless future of Tax System Redesign.

INFORMATION RETURNS PROGRAM

Senator ABDNOR: As a result of the Interest and Dividend Tax Compliance Act of 1983 (P.L. 98-67), IRS expanded its document matching program for interest and dividend income beginning with tax year 1983. With respect to IRS' overall Information Returns Program, Commissioner Egger said during last years' appropriations hearings that IRS expected to receive 926 million information returns in fiscal year 1985, a 48-percent increase since 1983, and that usable information returns were expected to total 719 million. IRS expected, however, to process all usable interest and dividend information returns.

Why are some interest and dividend information returns not usable? Are all those information returns not usable subject to backup withholding?

Mr. EGGER: A number of conditions can render an information return unprocessable. To start with, the information return must have a taxpayer identification number (TIN) or a mailable address so the TIN can be obtained. Then, some conditions which would make it unprocessable are: the type of information return -- Form 1099-INT, for example -- cannot be determined, or the kind of payment amount cannot be determined, such as "Dividends Qualifying for Exclusion" or "Dividends not Qualifying for Exclusion," or the payment amount cannot be determined because there is no decimal or it's in the wrong place; or the format does not lend itself to our processes, such as a listing of payees and amounts rather than separate payee documents.

Penalties can be assessed against filers of unprocessable documents, but backup withholding does not apply unless the TIN is wrong or missing.

Senator ABDNOR: Are all of the usable information returns which indicated a mismatch between the interest and dividend information returns and the information reported on the individuals tax return eventually pursued by IRS?

Mr. EGGER: For the 1982 tax year returns currently being followed-up for apparent underreporting, we are pursuing all cases related to interest and dividend income.

Senator ABDNOR: Does IRS have sufficient resources to pursue and collect all the taxes it finds unreported from Information Matching Programs?

Mr. EGGER: For FY 1986, IRS will have adequate resources to pursue and collect the taxes determined to be due as a result of the Information Matching Programs. We are making major improvements in pursuing and collecting taxes identified under the Information Matching Program. In FY 1986 we will streamline our processing procedures which will allow us to process more cases quicker. By FY 1987 we will double the volume of non-filer cases followed-up to about 700,000 or virtually all cases with a balance due.

Senator ABDNOR: Is the level of taxpayer compliance improving since the implementation of the Interest and Dividend Tax Compliance Act? Is that legislation sufficient to enable IRS to detect underreporting of interest and dividends or does IRS need further changes in legislation?

Mr. EGGER: Provisions of the act apply to tax returns for 1984 which are now being processed. Therefore, we have no data yet on levels of compliance under the act. We plan to compare 1982 and 1985 data from Taxpayer Compliance Measurement Program (TCMP) studies, but those results won't be available for several years. At this time, we have no recommendations for legislation on this subject.

Senator ABDNOR: Can IRS provide some idea of the extent of backup withholding that now takes place? Have financial institutions generally been cooperative in withholding money when backup withholding has been required?

Mr. EGGER: Since the implementation of backup withholding on January 1, 1984, 23,838 returns have been received from that time to September 30, 1984, reporting backup withholding of almost $46 million. The number of returns reporting backup withholding has steadily increased each quarter. This increase tends to indicate that the financial institutions are generally cooperative.

Senator ABDNOR: How many apparent non-filers are initially identified from this program? How many are eventually found to owe taxes? Are some non-filers entitled to refunds?

Mr. EGGER: For tax year 1980 returns, the latest year for which we have complete results, just over 1.5 million non-filers were identified. These resulted in 373,270 individual tax returns being filed. Of these, 185,767 had a balance due, 151,586 got a refund, and 35,917 were even balance.

Senator ABDNOR: Does IRS contact non-filers due refunds to advise them to file for a refund?

Mr. EGGER: We design our non-filer program to identify people who are required to file tax returns and to pin-point those likely to have a balance due the government. Those with apparent refunds will receive correspondence, but further contact is not likely. As I mentioned a moment ago, a substantial number of refund returns are submitted as a result of contact made through the non-filer program.

Senator ABDNOR: Last year, many banks and financial institutions requested individuals to supply their Social Security number on Form W-9 (Payer's Request for Taxpayer Identification Number). Some banks and financial institutions are again requesting the same individuals this year to return their Form W-9.

Is it necessary for individuals to annually certify the correctness of their Social Security numbers with the same financial institutions?

Mr. EGGER: Once a valid Form W-9 is received by the bank, annual certification is not necessary. If however, the customer failed to return the Form W-9 that was sent the prior year, then in order for the bank to avoid a potential penalty, it must send the Form W-9 to the customer again, requesting the certification of his or her social security number.

Senator ABDNOR: Does IRS have any suggestions as to how banks, financial institutions, or individuals could better handle the verification of the taxpayer identification number so that what seems to be an unnecessary burden (i.e., certification with the same parties involved) can be alleviated?

Mr. EGGER: The simplest method would seem to be to code accounts upon certification. As long as that account remains unchanged with respect to the client, no further certification would be necessary. Beyond that, an integrated computer system linking all accounts for a client would allow one W-9 certification to suffice for all accounts.

Senator ABDNOR: Given additional revenues generated through the matching of information returns to taxpayers tax returns and the impact such information return matching programs have on IRS' computer resources:

Does IRS have sufficient computer capacity to process and match the information returns currently being filed to the taxpayers' returns?

MR. EGGER: There is sufficient computer capacity to process and match current and projected receipts.

Senator ABDNOR: Does IRS have computer capacity available to process and match additional information returns that are not currently required?

Mr. EGGER: If additional filing requirements were to be established, the Service would acquire or contract for additional computer capacity to meet legal requirements.

Senator ABDNOR: Did IRS include in its computer equipment replacement program plans to expand the Information Returns Program?

Mr. EGGER: Because of Congressional concerns at the time, the Equipment Replacement Program was authorized as essentially a rollover replacement of existing equipment. An 8% annual growth rate was allowed for a 2-3% growth in the number of returns and a 5-6% increase due to unanticipated, mandated changes. Beyond this, however, no further expansion was authorized or assumed.

CRUDE OIL WINDFALL PROFIT TAX

Senator ABDNOR: With passage of the Technical Corrections Act (P.L. 97-448, January 12, 1983), the Congress clarified its intent that condensate from oil and gas wells is taxable as crude oil for windfall profit tax purposes.

What steps has IRS taken to develop and implement effective means for assuring that the tax on condensate is assessed and collected?

Mr. EGGER: In order to assure that the tax on condensate is assessed and collected, all windfall profit tax examiners have been advised that condensate from oil and gas wells is taxable as crude oil for windfall profit tax purposes. This is an examination item, and agents are directed to utilize the guidelines provided to them. This has been a training topic in our Continuing Professional Education program.

Proposed regulations under Internal Revenue Code section 4991, applicable to the condensate issue, have been drafted and are under review by Treasury.

Senator ABDNOR: How much windfall profit tax revenue is obtained from condensate? Does this revenue amount seem reasonable based on condensate production figures. In other words, what has been the compliance record in this area?

Mr. EGGER: Windfall profit tax revenues are accounted for by tier of oil and there is no separation within a tier for condensate. We have no hard data on revenue or compliance, but we have no reason to believe there is any widespread noncompliance.

Senator ABDNOR: Generally, oil-purchasing entities are responsible for withholding the windfall profit tax on all oil transactions in which they are the first purchaser. In reseller or exchange instances, however, it may be difficult for IRS examiners to determine who was the first purchaser of such oil and whether any tax was withheld.

How does IRS assure that the windfall profit tax has been assessed and collected on oil involved in exchanges or other multiple transactions?

Mr. EGGER: The Service initiates most windfall profit tax examinations at the operator level and, therefore, follows the sale of crude up to the first purchaser and/or down to the producer.

Senator ABDNOR: By law, the windfall profit on any barrel of oil is limited to 90 percent of the net income attributable to that barrel. Generally, producers calculate their net incomes after the end of the taxable year but windfall profit tax deposits are made quarterly. Thus, based on the "90 percent of net income limitation", major oil companies and other producers are filing claims requesting the refund of billions of dollars.

How do IRS examiners verify that these refund claims are accurate?

Mr. EGGER: During returns processing, claims are placed into two categories -- "A" and "B." Category "A" claims meet certain criteria and are considered for examination before refunds are issued. Generally, category "B" claims do not meet the certain specific criteria and are paid and later associated with the original return if the return is selected for examination in another way. For category "A" returns, normal classification criteria are used in reviewing the returns. The classifier will review all related documentation for the nature and inherent character of the claim, significance in relation to rest of the return, relationship with other items on the return and determine whether an examination is warranted. If a claim is selected for examination, it is examined in the same manner as any other return.

SENATOR ABDNOR: According to industry publications, many oil companies are planning tertiary recovery projects. The implementation of successful projects lowers the windfall profit tax rate on that additional oil produced to 30 percent from the previous applicable rate of 70 percent.

Are IRS' regulations adequate to prevent the certification of projects which are little more than waterflood projects with a surfactant added?

MR. EGGER: The regulations, when issued, will be adequate to prevent the classification of projects which are little more than waterflood projects with a surfactant added. A Notice of Ruling (proposed regulation section 1.4993) was published in the Federal Register on September 10, 1984, and public hearings have not been held to date.

Verification of planned tertiary recovery projects require the knowledge and expertise of petroleum engineers. Technical advice may also be requested from IRS, National Office.

All Forms 6458 (Certification and Election Form) are filed and stored at the Austin Service Center. The Austin Service Center provides copies of these forms to IRS engineer groups in the district offices in which the operators filing the forms are located. Examinations have been completed on all filers of these types of certifications to date.

Senator ABDNOR: Does IRS accept state certification without question or verification rather than make an independent evaluation of the tertiary project?

Mr. EGGER: No. Our examiners have been instructed that they should not rely on certifications granted by jurisdictional agencies since they may be based on plans and not necessarily on what was actually accomplished. They are told to carefully review all jurisdictional certified tertiary projects in accordance with the Windfall Profit Tax Act.

Senator ABDNOR: Alaskan North Slope crude oil pricing for windfall profit tax purposes has been discussed in congressional hearings in December 1982, February 1983, and September 1983. Meanwhile, IRS has been studying the Alaskan North Slope crude oil pricing issues since June 1982 and has issued some guidance on how the removal price of this oil should be calculated for windfall project tax purposes. Revenue Ruling 83-161, dated October 21, 1983, permits the producers to determine the removal price by netting-back, that is, by deducting from the actual sales price or market value in each market area, the arm's-length costs incurred in transporting the crude oil from the North Slope to that market. This ruling, however, does not address many of the differences in the net-back methods used by the producers, especially where the oil is transported on company-owned or controlled ships and refined in company-owned or controlled refineries.

Where a producer does not have third-party, arm's-length sales of North Slope crude oil in sufficient volume to establish a market price, does IRS plan to specify what

benchmark crude oils will be used to establish a value and what adjustments should be made for differences in oil quality and in credit terms?

Mr. EGGER: Even though a particular producer does not have sufficient third party arm's-length sales of North Slope crude oil to establish a market price, the producer normally has access to another North Slope producer's pricing data. The Service believes that the price established by actual third party arm's-length sales of North Slope crude by the second producer is a criteria that must be followed in valuing the first producer's crude. The Service plans to specify a price for North Slope crude based upon competing crudes sold or purchased in the West Coast market. We believe that there are sufficient third party sales on the West Coast to establish the Alaskan North Slope price.

Senator ABDNOR: Does IRS plan to examine all arm's-length sales of North Slope oil to insure that these sales are not just token sales to establish a lower market price or that these sales are not tied to other oil transactions between the same entities to establish a lower market price for North Slope oil?

Mr. EGGER: IRS looks into all arm's-length sales of North Slope oil. In addition to looking at arm's-length sales, the Service considers exchanges and/or sales tied to other oil transactions which might reflect the representative price of crude exchanged for Alaskan North Slope.

Senator ABDNOR: Is the Windfall Profit Tax Act and related regulations clear on when the North Slope oil should be valued, that is, upon removal from the wellhead premises or upon delivery to the lower-48 refinery, which may be 2 to 3 months later?

Mr. EGGER: The statute is not clear; therefore, producers use various methods in an attempt to comply.

Although the windfall profit tax becomes due upon removal from the premises (i.e., entering Pump Station #1), the price of said crude is subject to a netback computation from the "refinery gate" at the market to which it is delivered. The Service feels that the price of the oil in the particular market for which the crude is designated for delivery on the date of removal from the premises should be the price applicable to the particular crude for inter-company taxation.

Third party sales will be utilized as the sales price at time of said sale.

As a matter of fact, oil is not necessarily designated to a particular market at the time of entry into the Trans-Alaska Pipeline System (TAPS) and may not be designated to a particular market even when loaded for water transportation at Valdez; therefore, voluminous adjustments are made to previously reported windfall profit tax by all producers on the North Slope.

Senator ABDNOR: Since the quality of North Slope oil delivered to lower-48 refineries differs from the quality of taxable oil produced in the oil field (due to commingling in the Trans-Alaska pipeline), does IRS plan to issue guidance on what price adjustments should be made for quality differences?

Mr. EGGER: The Service does plan to require adjustments for quality difference, probably based upon gravity differential.

Senator ABDNOR: The Trans-Alaska Pipeline Authorization Act (P.L. 93-153, Nov. 16, 1973) establishes the Trans-Alaska Pipeline Liability Fund. This fund is to pay for damages, including clean-up costs, of discharges of oil from vessels loaded at the terminal facilities at Valdez. The fund of $100 million was accumulated by collecting a fee of 5 cents per barrel of oil loaded onto vessels at Valdez. At least four of the North Slope producers deducted the fees paid into the Liability Fund during the period March 1980 through September 1981 in netting-back to establish removal prices for North Slope oil. During this 19-month period, total fees paid by all the North Slope producers into the Liability Fund amounted to about $43.5 million.

Is it appropriate for the producers to deduct the 5-cent per barrel fee paid into the Liability Fund in computing the North Slope oil removal prices?

Mr. EGGER: We think not. Since Congress appeared to use the 5 cents liability fund payment in arriving at the Trans-Alaska Pipeline System (TAPS) tariff base amount of $6.26 (average tariff paid $6.21 plus 5 cents), this would result in a double deduction.

Senator ABDNOR: What guidance has IRS provided to the producers?

Mr. EGGER: No specific guidance has been provided to the producers, other than discussions of the IRS position that the item is not deductible in the netback computation.

Senator ABDNOR: Is this fee considered a cost of transportation?

Mr. EGGER: We think not. Since Congress appeared to use the 5 cents liability fund payment in arriving at the Trans-Alaska Pipeline System (TAPS) tariff base amount of $6.26 (average tariff paid $6.21 plus 5 cents), this would result in a double deduction.

Senator ABDNOR: Producers deduct the Trans-Alaska Pipeline System (TAPS) tariffs paid for transporting North Slope crude oil through the 800-mile pipeline in computing removal prices. Each of the eight owners of TAPS established a common carrier tariff that is subject to the Federal Energy Regulatory Commission's approval. However, these tariffs, initially filed in 1977, are still in dispute and have not been finally approved by the Federal Energy Regulatory Commission. There could be a need to make windfall profit tax liability adjustments if the Commissioner sets lower tariffs than those filed.

Given the uncertainty as to appropriate tariff rates, how does IRS plan to handle the TAPS tariffs in determining the amount of windfall profit tax on Alaskan North Slope oil?

Mr. EGGER: Any examination of Alaskan North Slope (ANS) production which are completed, leaving open only the issue of Trans-Alaska Pipeline System (TAPS) tariff, will be closed out by the Service under letters of agreement or closing letters which extend the statute of limitation for assessment for that issue only. If an individual taxpayer refuses to extend such an agreement, the Service would have no alternative but to make a determination as to the correct tariff and propose a discrepancy. Because of the TAPS tariff adjustment clause n the initial Crude Oil Windfall Profit Tax Act of 1980, the above stated problem makes little, if any, difference prior to 1983. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), under section 284, removed the TAPS tariff adjustment and thus, the Service will need to protect the statute of limitations and/or propose appropriate deficiencies upon examination.

Senator ABDNOR: Alaska North Slope crude oil production averages about 1.6 million barrels per day and, of this amount, about 1.3 million barrels per day are subject to windfall profit tax. If IRS adjusts the producers' windfall profit tax liability upward by only 1 cent per barrel, the increased windfall profit tax liability of the North Slope producers is over $7,700 per day or about $2.8 million per year.

How much additional windfall profit tax does IRS anticipate is owed on 1980, 1981, 1982, 1983, and 1984 production?

Mr. EGGER: Under Title 26 USC 6103 the Service is prohibited from discussing particular taxpayers and/or taxpayers who could readily be identified. A statement as to additional windfall profit tax due would probably indicate that certain producers are currently under examination or who have been examined by the IRS, and we believe this would be an unauthorized disclosure.

Senator ABDNOR: What is IRS doing to keep the statute of limitations from running on windfall profit tax returns for Alaska North Slope crude oil for 1980 and later years?

Mr. EGGER: The Service is very careful not to allow the statute of limitations to toll. Taxpayers are requested to consent to an extension of the statute of limitations on assessment. If all other issues are resolved, the extension may be limited to the unresolved issues. If a taxpayer refuses, the Service will, as a normal course of action, assess a deficiency.

EMPLOYEE MISCONDUCT

SENATOR ABDNOR: During this past year, there have been newspaper accounts of IRS agents taking bribes. In this connection can IRS provide some idea of the resources IRS devotes to internal security to ferret out employee misconduct in the Service?

MR. EGGER: At the present time IRS has 318 Internal Security Inspectors on-roll. Based on an average of the past three fiscal years, these Inspectors spend approximately 52% of their criminal misconduct investigative time investigating employee misconduct. This also includes conducting systematic probes of high risk areas of Service operations. The remaining 48% of their criminal misconduct time is devoted to non-employee criminal misconduct investigations such as attempts to corrupt or assault IRS employees.

SENATOR ABDNOR: Is the number of IRS employee violations increasing or has the Service been experiencing relative stability in the matters of employee misconduct?

MR. EGGER: We have had no adverse trends surface during the past three fiscal years. The number of instances of employee misconduct investigated by the Internal Security Division has remained relatively stable. The one exception over the past three fiscal years involved a project we initiated concerning unemployment compensation fraud. This investigation resulted in approximately 270 employees being prosecuted nationwide. The employees were primarily in the "when actually employed" (WAE) status working as part-time employees in our Service Centers.

FEDERAL/STATE/LOCAL TAX INFORMATION EXCHANGE PROGRAM

Senator ABDNOR: There are several factors which limit the usefulness of State audit information provided to IRS, one of which is the federal statute of limitations. While IRS can obtain a three year extension on the statute of limitations if a taxpayer fails to report income, the extension only applies where the omitted income is 25 percent or more of total reportable income according to section 6501(e) of the code. It appears that section 6501(e) not only is inequitable since it favors taxpayers with more reportable income but it also limits IRS' ability to pursue known instances of underreporting identified by State tax information exchange.

What has IRS done to assess the cost of section 6501(e) on their audit efforts under the Federal/State exchange program?

Has IRS considered remedies to address the inequities and limitations of section 6501(e) on tax information received from the States?

Mr. EGGER: Section 6501(e) provides an exception to the normal limitations on the assessment and collection of taxes. The normal 3-year statute of limitations is extended to a 6-year statute of limitations if the taxpayer omits from gross income an amount in excess of 25 percent of the gross income which was reported on the tax return.

The Service considers the 25 percent criterion an equitable approach to determining at what point the 6-year statute should come into effect. The use of a static percentage is fair to all taxpayers regardless of their reported income

because it provides a consistent definition of what is considered a "substantial omission of income" for purposes of this section.

Although it may at first appear that taxpayers may take advantage of the 25% criterion to omit significant amounts of income and continue to rely on the normal 3-year statute of limitations, section 6501(c) provides that if a false or fraudulent return has been filed, there is no statute of limitations for the assessment or collection of tax.

For these reasons, we do not perceive section 6501(e) as limiting the usefulness of State audit information.

Should we receive State audit information which discloses a significant amount of omitted income that does not meet the 25% criterion, we would approach our examination in one of two ways. If the normal 3-year statute of limitations had not expired, we would request an extension of the statute of limitation period from the taxpayer to provide additional time for a determination for Federal income tax purposes. If we did not have sufficient time to accomplish this or if the taxpayer refused to extend the statute, a notice of deficiency would be issued based on the information available.

In the event the normal statute of limitations has expired before we receive the State audit information, we would look to the taxpayer's subsequent year return to determine whether the taxpayer has consistently omitted significant amounts of income.

If we determine that the taxpayer has a pattern of omitting income, the possibility of a fraud investigation would be considered. In a fraud investigation, the State audit information could be considered because there would be no statute of limitations.

Because of these audit tools which are available to us, we do not feel that there are any significant additional costs incurred because of the 25% criterion of section 6501(e).

Senator ABDNOR: Part of the "Spending Reduction Act of 1984" authorized the IRS to disclose return information with respect to unearned income to federal, state, or local agencies administering Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), Medicaid, food stamps, and the cash assistance programs administered in Puerto Rico, Guam, and the Virgin Islands.

To what extent have other federal, state, or local agencies requested unearned income tax data from IRS to verify income or eligibility?

Mr. EGGER: At this point no formal requests for information have been received. This is only because the IRS has been developing, in coordination with other federal agencies, a formal system for obtaining this information. In addition, regulations have yet to be finalized by the Department of Health and Human Services that govern state and local agency use of this information.

Working closely with a task force implementing the eligibility verification measures contained in the Spending Reduction Act, the IRS has moved quickly to publish a revenue procedure which sets forth the instructions for obtaining IRS data. The system we have designed allows federal, state, and local agencies to obtain this information via magnetic tape.

Formal requests for this information can be made on or after April 8, 1985, the publication date of the revenue procedure. Actual extracts of data will begin in July 1985.

Although no formal requests have been made yet, we have been in contact with interested agencies. We know that the Social Security Administration, which administers the SSI program, will request data on approximately 4 million individuals. Preliminary discussions with representatives of federal agencies with oversight responsibility for the other programs show the potential for up to 165 state agencies to request data on up to 40 million individuals. However, the actual extent of participation is unknown at this point.

Senator ABDNOR: Is IRS advised as to how the unearned income data benefited the other agencies in administering their programs, such as AFDC or food stamps?

Mr. EGGER: Since IRS data has not been disclosed yet, we have no information on how useful the information is. SSA has advised us that their preliminary studies show the possibility of $96 million in savings over a 6 year period with the information they will receive in 1985 alone. In contrast, the Senate Finance Committee Report for the Deficit Reduction Act estimated that use of this information for all programs over a 4 year period would result in savings of $660 million.

Senator ABDNOR: Does the IRS have any evidence that there is or will be less tax compliance because of the recent disclosure provision of the Spending Reduction Act?

Mr. EGGER: There is no information at this point as to what effect disclosure of this information will have on compliance.

Senator ABDNOR: What resources is IRS required to provide other agencies as a result of this provision?

Mr. EGGER: IRS is not required to provide any resources to other agencies under this provision. IRS data will be provided pursuant to a reimbursable contract between the IRS and the requesting agency. To minimize the impact on IRS resources, this will be a magnetic tape exchange program, with IRS extracting the data using magnetic tapes provided by the requesting agencies and providing the same agencies with the data on magnetic tape.

Senator ABDNOR: Is IRS making maximum use of data that may be maintained by those agencies now authorized access to IRS tax data?

Mr. EGGER: The provision authorizing these agencies access to IRS tax data does not authorize IRS to obtain any data from those agencies. However, as a separate initiative, the IRS is in the process of identifying state data that may be useful for tax administration purposes which it is currently not using. Data which these agencies

have and which would be useful to IRS would be identified as part of this effort.

Senator ABDNOR: To what extent does IRS insure itself that other federal, state, and local agencies using tax information are properly safeguarding such data?

Mr. EGGER: The IRS has revised Chapter (37)00, Safeguard Review Program, of our Disclosure of Official Information Handbook, to provide for on-site safeguard reviews of all agencies over a five year cycle. Our Publication 1075, Tax Information Security Guidelines for Federal, State, and Local Agencies, is being updated to bring into its purview those agencies receiving return information under the Spending Reduction Act of 1984. Finally, we are continuing our discussions with representatives of federal agencies to establish and implement a safeguard review program encompassing state and local agencies receiving tax information under the Act.

INTEREST PAYMENTS ON TAX RETURNS

Senator ABDNOR: The amount of interest IRS pays on taxpayer overpayments has increased from about $500 million in fiscal year 1980 to almost $2 billion in fiscal year 1983. TEFRA gave IRS some measure of relief by providing that no interest will be paid until a return is filed in a form suitable for processing. TEFRA also changed the means by which interest is calculated for tentative carrybacks and delinquent filers. As a result of TEFRA and declining interest rates, IRS interest payments declined to about $1.3 billion in fiscal year 1984. What are the reasons IRS attributes to interest payments remaining sizable?

Mr. EGGER: In 1980 the rate of interest was 6%. Since then, the rate has fluctuated between 11 and 20%. In fiscal year 1984 nearly $700 million of interest was paid on individual and corporate tax adjustments. This represents 54% of all interest paid in fiscal year 1984. Interest paid on original returns filed (original settlements) represents 24% of the interest paid. The interest paid on audit adjustments or amended returns may require the payment of interest for any period up to three years from the date of original filing. Lately, there is a trend for taxpayers to file closer to the return due date. This causes the Service a problem of timely processing returns within the 45 day interest free period. The volume of individual returns filed during the three to four weeks prior to the due date represents one-third of all individual returns filed.

Senator ABDNOR: What initiatives, if any, is IRS considering to reduce the amount of interest payments? What are the associated costs and savings of each initiative?

Mr. EGGER: The Service has, over the past several years, initiated programs to monitor returns being processed. These programs are designed to identify refund returns that may not, under normal conditions, be processed within the 45 day interest free period. Service center procedures require them to expedite those refunds where the interest free processing period is in jeopardy.

The service centers also review interest paid on returns to determine if procedural or program changes can be made to prevent future payment of interest.

The General Accounting Office (GAO) has, during the past two years, performed an in-depth review of IRS interest payments. They will in the near future provide us with an official report of findings. During the preliminary review of their findings, recommendations for the saving of interest were made. Some of these recommendations will require legislation.

The associated cost to implement the Service initiatives was minimal. We did not retain the savings of our initiatives separate from changes made by TEFRA or other legislation.

Senator ABDNOR: In assessing interest saving initiatives, to what extent does IRS consider increased government borrowing costs--the result of issuing refunds sooner?

Mr. EGGER: While it may be desirable to issue refunds sooner and reduce interest costs, potential interest savings are partially offset by increased government borrowing costs. The Service does not consider increased government borrowing cost in assessing interest savings initiatives as it relates to issuing of refunds. It has been the policy of the Service to issue refunds as soon as possible and within the allotted interest free processing period.

Senator ABDNOR: What, if any, additional legislative remedies does IRS endorse:

Mr. EGGER: We have several interest saving initiatives that are currently being considered for submission for legislative change.

1. As I mentioned earlier, with the growing trend of taxpayers delaying the filing of their returns until the return due date, we are placed in a posture to get the refunds out at any cost. In the past several years, the returns have become more and more complicated and contain more schedules then ever. These taxpayers tend to delay filing until the last minute. We are considering proposing to change the interest free processing period from 45 to 60 days.

2. We currently have a 45 day interest free processing period for only originally filed income tax returns for individuals, corporations, Trusts, and Exempt Cooperatives. On all other types of tax returns, we do not have an interest free processing period. Therefore, interest on all overpayments of tax begins to accrue from the due date of such returns until the returns are processed and the tax liability is assessed. We are considering proposing a change to allow an interest free processing period for those returns that currently do not have such a period.

3. With the current interest rate at 13%, a shrewd taxpayer may want to wait until the last moment to file an amended return as the government interest rate is much higher than could be earned at a depository. Therefore, we are considering proposing to allow interest from the date the amended return is filed rather than from the original due date which may have been three years prior.

INTERNATIONAL TAX MATTERS

INFORMATION EXCHANGES

Senator ABDNOR: Total direct international investment has increased from $65.8 billion in 1960 to $545.6 billion in 1981. IRS has responded to this growing and complex economic integration through several information exchange programs which it carries out under U.S. tax treaties.

Under the routine information exchange program in 1980, U.S. tax treaty partners provided IRS with 793,000 information returns, reflecting $11.6 billion in foreign-source income earned by U.S. taxpayers. About 129,000 of the 793,000 returns, totaling $10.9 billion, represented payments to businesses. None of these returns were matched against tax returns because IRS does not have a document matching program for business tax returns. Further, 321,000 of the foreign information returns, reflecting $323,000 million in income earned by individual U.S. taxpayers, were not matched against tax returns. This was because the foreign information returns (1) were incomplete (for example, they contained no taxpayer identification number) or (2) were received too late to be processed by IRS.

Is IRS planning to institute a business matching program to assure that foreign-source income reflected on foreign information returns is properly reported?

Mr. EGGER: The Service has in place a Foreign Information Document Program (FIRP), that was initiated in June, 1983 to identify and utilize information documents received from foreign countries. FIRP matches foreign information documents to both individual and business returns.

Senator ABDNOR: What steps has IRS taken to increase the usefulness of the foreign information returns it receives from treaty partners?

Mr. EGGER: The usefulness of the Foreign Information Return in the Information Return Program is restricted due to a number of factors. These factors include: timely receipt and completeness of the documents, foreign languages, lack of Taxpayer Identification Numbers, and the substantial number of different forms sent to us by a treaty partner.

The IRS continually stresses to its treaty partners the importance of the quality and timely receipt of the documents. In addition, IRS has encouraged the standardized reporting of information. Implementation of a standard form would better facilitate processing by reducing the number of different forms sent and it may decrease, to a certain extent, the translation process. As a result of IRS efforts, two major treaty partners now use the OECD Standard Form to exchange information. The Service has also noticed some improvement in the timely receipt of information documents from some countries.

We have also encouraged our treaty partners to file documents on magnetic media. The IRS is currently working with major

Canadian payors of Canadian source income in an effort to have the information filed on magnetic media.

As noted previously, the Service has emphasized the importance of timeliness and quality of the information. These factors and the use of the standardized form have been major points of discussion with our new treaty partners. In an effort to increase the usefulness of the foreign data, we are studying these foreign documents currently not processed in the FIRP process with a view towards other possible alternative uses of the information.

The U.S. has implemented a dollar tolerance level on documents we exchange and most of our treaty partners have adopted this concept for information they send us. Treaty partners claim that by reducing the number of documents sent, it will enable them to devote more resources to perfecting the documents which are exchanged.

To utilize more of the information received, the IRS has established a secondary compliance program. Documents in excess of an established dollar criteria are manually classified and studied for potential compliance value. This program provides greater latitude for using the data from foreign documents that fail to meet the strict IRP criteria. Thus, a prior year document that is othewise complete would provide a useful source of information.

Senator ABDNOR: Under the specific exchange program, IRS annually sends to treaty partners about 500 requests for specific information on tax-related matters. In return, IRS receives about 400 such requests for information annually from treaty partners. While IRS officials rated treaty partner cooperation good or very good for 21 of 27 participating countries, the 6 countries that were rated fair or poor account for about 22 percent of U.S. direct investment abroad and 28 percent of foreign direct investment in the U.S. What specific action has IRS taken to improve the cooperation received from treaty partners?

Mr. EGGER: During fiscal year 1984, IRS sent 131 requests for specific information on tax-related matters to treaty partners, and received 240 such requests from treaty partners.

In its effort to make the specific exchange program as effective as possible, IRS continually monitors and evaluates the activity with treaty partners. At the Group of Four (G-4) and Pacific Association of Tax Administration (PATA) meetings this subject has been a frequent agenda item discussed with participating tax officials of the United Kingdom, France, Germany, Canada, Australia and Japan in an effort to secure a high level of exchange. Several specific meetings have been held with these and other treaty partners where it was felt that the program was not functioning properly. In one instance we wrote to the competent authority and advised that in the absence of reciprocity, the IRS would curtail further expenditures of time and effort on behalf of that treaty partner.

In addition, during the certification process to determine those treaty countries eligible for Foreign Sales Corporations (FSC), we reviewed our specific exchange experience with each of our treaty partners. During this process we identified any significant problems we were encountering with specific treaty partners. Again meetings

and iiscussions were held with foreign officials where these problems were raised. Where the significant problem could not be overcome, the country did not receive FSC certification. In total, 23 countries were certified in this process.

Senator ABDNOR: Is the U.S. getting a fair return on the information it provides to treaty partners? That is, is the tax revenue lost through specific information exchanges offset by the tax revenue gained? Can IRS provide specific examples where specific information exchanges resulted in the collection of additional tax revenue?

Mr. EGGER: In general, IRS believes the U.S is getting a fair return in the specific exchange program. Some countries have a far better record than others in terms of responsiveness and reciprocity. While the specific, official, responses from some countries would indicate a lesser degree of responsiveness, in many instances, these same countries will allow IRS representatives to gather information or do on-site examinations.

While dollar figures are not maintained on the "value" of information we request or forward, it is generally extremely valuable for both treaty partners. The specific exchange program is used to gather information in order to determine the proper amount of tax owed to the taxing authority. There are seldom situations where a question exists as to whom the taxes are owed.

To enable us to measure the value of the information received from our treaty partners, we request specific feedback from our District offices on the usefulness and quality of the information obtained. In several instances our attempts to secure tax return data for treaty partners revealed returns that the U.S taxpayers had not filed. These returns were subsequently secured by the District offices. In addition, IRS District Counsel has informed us that the information and assistance provided by the treaty partner was extremely helpful in resolving individual tax cases. Many District offices have commented that the information provided by the treaty partner was very beneficial in supporting proposed tax adjustments and/or criminal prosecution.

SENATOR ABDNOR: Under the simultaneous examination program, each participating country separately and simultaneously audits the entities of a common taxpayer located in its jurisdiction. The main focus of the 13 cases conducted in fiscal year 1984 was transactions involving tax haven countries. Many IRS officials and corporate taxpayers believe that this program could improve if it focused to a greater extent on transfer pricing and double taxation issues.

To date, how has the simultaneous examination program aided IRS compliance efforts?

Mr. EGGER: The Simultaneous Examination Program has aided IRS compliance efforts in the following areas:

1. Through exchanges of information under our tax treaties we are able to obtain books, records and other data not available to our personnel conducting domestic examinations. The information exchanged primarily concerns the transfer pricing of

transactions conducted through tax haven countries by related parties.

2. Through the case recommendation process we practice with our treaty partners in selecting cases for simultaneous examination, tax avoidance and other transfer pricing schemes involving tax havens are brought to our attention in situations which on the surface would not appear to warrant examination activity. For example, our treaty partners may spot unusual schemes involving their taxpayer, and will notify the Service that a related U.S. taxpayer is either directly or indirectly involved in the same scheme or may be involved in similar schemes.

3. Through the conduct of a simultaneous examination, particularly where a foreign parent company is involved, we are able along with our treaty partners to piece together worldwide organizations and operations of taxpayers, trace the flow of transactions from one national boundary to another, and to isolate and evaluate economic functions performed by related entities.

4. Through the procedures followed in conducting a simultaneous examination, the exchanges with our treaty partners enable us to identify audit techniques practiced by other tax administrations; to evaluate the application of foreign tax law concerning transactions involving domestic taxpayers; and to verify documents and statements provided to us by the representatives of taxpayers. In certain situations, our notification to the taxpayer of a simultaneous examination has inspired additional cooperation on the part of the selected taxpayer.

5. Through the exchange of specific information which takes place during a simultaneous examination we are better able to enforce the arm's-length standard required by Internal Revenue Code Section 482 in determining the allocation of income or expenses between related parties particularly transfer pricing transactions involving tax haven countries.

Senator ABDNOR: Does IRS plan to expand this program to focus more on transfer pricing and double taxation issues? If so, could the competent authority function be streamlined as a result?

Mr. EGGER: We have generally targeted transfer pricing transactions involving tax haven countries in our case recommendations to our treaty partners. Through our participation with foreign tax administrations in international groups such as the Pacific Association of Tax Administrators (PATA) and the Group of Four, we have encouraged the use of simultaneous examination procedures to include individuals and smaller corporate entities as well as large multinational corporations. This expansion of our case selection process provides us the ability to introduce treaty exchanges of information into examinations which are less resource intensive as those encountered in large multinationals. Our efforts in expanding simultaneous examinations have also been directed to increasing the number of treaty partners with whom we conduct simultaneous examinations. We believe that as the number of tax

administrations involved in simultaneous examinations increases taxpayer compliance will also increase.

The Service currently does not select a case for simultaneous examination when the primary tax issue between the U.S. and a treaty partner would involve double taxation. In conducting a simultaneous examination, we believe our resources are best utilized in developing tax issues involving the use of tax havens to avoid or evade the taxes of the United States and/or our treaty partners. We believe that double taxation issues which arise between the United States and one of its treaty partners are best resolved under current competent authority procedures rather than employing simultaneous examination procedures.

Senator ABDNOR: What has IRS done to promote the use of simultaneous examinations in sensitive audit areas such as the U.S. banking or the Japanese automobile industries?

Mr. EGGER: The simultaneous examination procedures are used on a case-by-case basis where information will be exchanged, under provisions of our income tax treaties, on a specific taxpayer. The Service, in order to gain a better understanding of the worldwide operations and practices of certain industries, has established a program to conduct Industrywide Exchanges of Information with treaty partners. The principle objective of these exchanges is to secure comprehensive data and information on an industry basis which enables a more effective and knowledgeable review of the tax returns of enterprises operating in a selected industry. The Industrywide Exchange of Information Program with our treaty partners is a complement to our Industry Specialization Program and is intended to gain knowledge of the worldwide operations of selected industries. The Industrywide Program also leads to industry members being recommended and accepted for simultaneous examination. We have actively promoted industrywide exchanges without regard to sensitivity. An industrywide exchange of information has, in fact, been conducted on the banking industry.

Senator ABDNOR: TEFRA required information reporting by U.S. corporations and foreign corporations engaged in business in the United States that are 50 percent or more controlled by a foreign person at any time during a taxable year. This requirement applies to reporting corporations beginning after 1982, but as of the end of 1984 the regulations had not been published. When does IRS plan to have these regulations issued?

Mr. EGGER: On December 19, 1983, the Federal Register published proposed regulations under section 6038A of the Internal Revenue Code. A public hearing was held on March 29, 1984. The principal purpose of these regulations is to facilitate determinations by the Service as to whether corporate income is being accurately reported and whether adjustments under section 482 between the related entities are necessary to assure clear reflection of income. Although, the regulations generally were well received, commentators expressed concern about the burden of collecting and reporting

information accurately and on time. We intend to respond to some of their concerns. We have largely developed the final regulations, and we hope to issue them in the near future.

Senator ABDNOR: Will foreign-owned U.S. corporations be required to report the same level of detail as U.S. corporations having foreign subsidiaries? If not, please explain.

Mr. EGGER: Section 6038A requires foreign-owned U.S. corporations that have related foreign party transactions to provide certain information about these related corporations. If a reporting U.S. corporation has transactions with a related foreign corporation, the reporting corporation is required to provide information about these transactions. The types of transactions subject to reporting include (1) sales and purchases of stock in trade; (2) sales and purchases of tangible property; (3) rents and royalties paid and received; (4) sales, purchases and amounts paid and received for use of intangible property; (5) consideration paid and received for certain services; (6) commissions paid and received; (7) amounts loaned and borrowed in the ordinary course of business; (8) interest paid and received; and (9) premiums paid and received for insurance and reinsurance. In general, the same type of transactional information is presently required under section 6038 with respect to U.S. corporations having foreign subsidiaries.

Senator ABDNOR: TEFRA also added section 982 to the Internal Revenue Code, establishing a "formal document request" procedure designed to discourage taxpayers from delaying or refusing disclosure of certain foreign-based information to IRS.

How many times has the "formal document request" procedure been used since the passage of TEFRA?

Mr. EGGER: Although statistics have not been maintained, the actual issuance of formal document requests has been limited. The threat of the issuance of formal document requests has, however, been a frequently used and effective examination technique. Taxpayers faced with the possibility of suffering the penalties provided for in section 982 have regularly provided requested foreign-based records prior to the issuance of a formal document request. Section 982 has therefore been effective in assisting the IRS in completing examinations timely.

Senator ABDNOR: In the cases where the "formal document request" procedure was used, was more information obtained than could have been obtained without the procedures?

Mr. EGGER: Formal document requests have been effective in allowing the Service to obtain foreign-based documentation which may not have been made available were it not for the section 982 provisions which prohibit subsequent introduction of the records by the taxpayer. Prior to TEFRA, there was a need for much more reliance on the cooperation of taxpayers in furnishing foreign-based information.

FOREIGN INCOME EXCLUSION

Senator ABDNOR: Section 111 of the Economic Recovery Tax Act of 1981 allows U.S. citizens living abroad to exclude a portion of their foreign earned income from their U.S. taxable income. For tax year 1984, U.S. citizens residing abroad could exclude up to $80,000. While the provision was expected to significantly reduce the taxes owed by these individuals, statistics regarding the tax revenue impact of the exclusion are not yet available from IRS. The Congress, however, believed the provision would stimulate U.S. foreign trade by making it financially more attractive for U.S. citizens to live abroad. It was felt that these individuals could maintain and service American products and supervise their use, thereby making the products more attractive to foreign buyers. However, the United States' ever increasing budget deficit now raises questions about the potential trade benefits versus the tax revenue foregone as a result of the exclusion.

What has been the effect of the exclusion on the tax revenues generated from U.S. citizens abroad? Are there any projections of future tax revenue losses attributable to the foreign earned income exclusion?

Mr. EGGER: The Joint Committee on Taxation, in its publication, Estimates of Federal Tax Expenditures for Fiscal Years 1984-1989, shows the following estimates of revenue loss due to the foreign earned income exclusion.

Fiscal year	Revenue loss ($millions)
1984	1,300
1985	1,405
1986	1,475
1987	1,550
1988	1,625
1989	1,710

Senator ABDNOR: How many tax returns are filed annually by U.S. citizens residing abroad? How does this figure compare to the number of U.S. citizens residing abroad? Is there a compliance problem?

Mr.EGGER: We do not know how many returns are filed by U.S. citizens residing abroad. We do not have any way of identifying all such returns because they may not have any foreign source income and may not even have a foreign address. (Some are filed, for example, with the address of their U.S. attorney.)

Nor do we have a good estimate of the number of U.S. citizens living abroad. We can determine the number of military personnel and government employees stationed abroad but we have no good basis for estimating the number of retirees, employees of private concerns and the self-employed who are U.S. citizens and reside abroad. It should be noted that we would not expect these two totals to be the same. Because of the income levels necessary for filing a U.S. income tax return, not all U.S. citizens living abroad are required to file a tax return.

Senator ABDNOR: Does IRS have statistics on the amount of passive income (dividends, interest, etc.) reported by U.S. citizens who reside abroad and claim the foreign earned income exclusion? If so, how much passive income is reported by how many taxpayers?

Mr. EGGER: The most recent information we have is for tax year 1979. It shows that the amount of passive income reported on returns with the foreign earned income exclusion was about $49 million. The data also show that there were approximately 60 thousand returns claiming the exclusion. We do not know, however, how many returns out of the 60 thousand actually reported the passive income.

FOREIGN EARNED INCOME EXCLUSION

Senator Abdnor: Have there been any studies that assess the benefits or drawbacks of the foreign earned income exclusion?

Mr. Egger: Several U. S. Government studies have been done on the merits and drawbacks of the special tax rules applicable to foreign earned income, but they pre-date the 1981 change in law which introduced the present exclusion. The Treasury Department is required to report to the Ways and Means and Finance Committees on the operation of the existing exclusion based on returns filed in 1984 for income earned in 1983. That report, accordingly, will not be available until next year. The earlier studies referred to above are:

U. S. Treasury Department, "Taxation of Americans Working Overseas: Revenue Aspects of Recent Legislative Changes and Proposals," February, 1978.

General Accounting Office, "The Impact on Trade of Changes in Taxation of U. S. Citizens Employed Overseas," February, 1978.

Congressional Research Service, Library of Congress, "U. S. Taxation of Citizens Working in Other Countries: An Economic Analysis" (by Jane G. Gravelle and Donald W. Kiefer), Report 78-91E, April, 1978.

U. S. Department of Commerce, "U. S. Policy Toward the Taxation of Foreign Earnings of U. S. Citizens" (by Dr. Roy Plough), August, 1978.

U. S. Treasury Department, "The American Presence Abroad and U. S. Exports" (by Professor John Mutti), October, 1978.

Executive Office of the President, Report to Congress; "Equitable Tax Treatment of United States Citizens Living Abroad," January, 1980.

INTERNATIONAL ENFORCEMENT

Senator ABDNOR: IRS' International Enforcement Program (IEP) is responsible for the examinations of business operations outside the U.S. -- the majority involving multinational corporations. The IEP emphasizes international tax compliance activities involving tax havens and operations by individuals, partnerships, and trusts. Currently, about 325 international tax examiners are assigned to IEP.

What are the major problems encountered by international tax examiners in pursuing tax haven issues? What can be done to resolve these problems?

Mr. EGGER: The major problems encountered by international examiners in pursuing tax haven issues are related to the detection of tax haven use, and facts to uncover specific schemes involving tax haven use by taxpayers. We are addressing these problems through information gathering projects nationwide, by the use of such information as that provided in Treasury Form 90.22-1, and through expanded information sharing with treaty partners through simultaneous examinations, and spontaneous and industry-wide exchanges. Improved classification procedures as well as continual training and updating for examiners at all levels throughout the country are also being used to resolve these problems.

Senator ABDNOR: Given the tremendous growth in international trade and finance activities, can 325 tax examiners adequately examine and monitor international tax activities of individuals and corporations?

Mr. EGGER: For the present, we think the 325 international specialists are pretty much in balance with overall Examination resources and coverage. I might add that these specialist revenue agents do not "go it alone" in audits; their role is to assist and advise the agents in charge of the examinations. Many times, the international specialist is one member of a team of agents working together on a large examination.

Senator ABDNOR: Has IRS evaluated the effectiveness of its international enforcement efforts? What were the results of the evaluation? Have any changes been made and/or recommended?

Mr. EGGER: A recent internal audit reviewed the International Enforcement Program to determine how well the Service measures and promotes voluntary compliance concerning international transactions and to what extent the Service uses the various foreign returns and documents it receives. Internal audit concluded the IEP has effectively promoted voluntary compliance through examinations. To further improve the overall international compliance program, internal audit recommended the Service should study ways to determine the full scope, growth and level of compliance concerning international transactions, and to develop more effective uses of the information it receives. Specifically, internal audit recommended the Service should consider:

-- Obtaining and accumulating immediate feedback from returns currently under examination to determine if there is a serious compliance problem.

-- Strengthening procedures and guidelines to ensure that the various international returns or documents filed by taxpayers or related entities are made available tc agents examining returns.

-- Reviewing the potential offered by IRC Sections 6041(b), 7001 and Regulation 1.6041-4 that require any person who collects certain foreign items as a matter of business or for profit to obtain a license and to provide the IRS with the amount paid and the name and address of the recipient of each payment.

All of the internal audit recommendations have been implemented.

Senator ABDNOR: With the dramatic increase in the economic significance of multinational enterprises in recent decades, as much as 25 percent of world trade now involves intercompany or related party transactions. Consequently, tax liability adjustments proposed by IRS and/or foreign auditors frequently result in double taxation for the enterprise. Relief from double taxation is found in the mutual agreement procedure article of tax treaties. Generally, these treaties provide for each country's tax administration officials (the "competent authorities") to confer and mutually agree on appropriate adjustments eliminating or mitigating double taxation.

IRS revenue rulings require taxpayers to request competent authority assistance as a condition to later allowance of a foreign tax credit as an alternative form of relief, in the event a competent authority settlement cannot be reached. How does IRS administer/monitor this requirement to ensure compliance?

Mr. EGGER: By way of a brief background, taxpayers often found it easier to achieve relief from double taxation through the mechanism of the U.S. foreign tax credits rules rather than through the use of the competent authority process. The result of such alternative action was to provide a measure of double taxation relief to taxpayers, but at the expense of Treasury revenues.

To protect U.S. economic interests in this situation, the IRS issued the revenue rulings (Rev. Rulings 76-508; 80-231) you mentioned. These rulings, in essence, put taxpayers on notice that

failure to effectively use the competent authority process after such tax liability adjustment is made will result in a denial of additional foreign tax credits otherwise available.

To further ensure compliance in this area, the position of the IRS as stated in these rulings has been incorporated in the income tax regulations (under Sec. 901). As such, the position of the IRS now has the full force of law.

Administratively, there are mechanisms in place to help ensure compliance:

1. Income tax audit manuals used by field personnel stress the importance of the competent authority process, and remind tax examiners of their responsibility to protect U.S. interests in this matter.

2. The U.S. Competent Authority and/or his staff frequently participate in IRS training courses, and in private sector seminars to discuss and to encourage the use of the competent authority process.

3. Finally, the U.S. Competent Authority is undertaking a comprehensive study to determine why taxpayers are not utilizing, to a great degree, the competent authority process. Part of this study will necessarily evaluate the monitoring of compliance by IRS personnel and by taxpayers with the revenue rulings and regulations.

Senator ABDNOR: In a June 1984 meeting of the Advisory Group to the Commissioner of Internal Revenue, IRS officials acknowledged that "it is readily apparent that many taxpayers who should be utilizing the competent authority process to obtain relief from double taxation are not doing so" and that a "case gap in this area is a serious concern because it can mean a loss in revenue for the Treasury." What actions is IRS taking to correct this situation?

Mr. EGGER: The IRS has recognized that although the number of U.S. initiated international adjustments has increased in recent years, the number of competent authority requests has not correspondingly increased. This gap is indeed a serious concern to the IRS because of the loss of revenue involved.

As previously mentioned, a task force has been formed to study this so called "case gap". Its goal is to identify those areas which have contributed to the case gap, and to recommend corrective actions. To this end, the task force has solicited views from IRS personnel, from taxpayers and their representatives, and from tax and business organizations.

Although the study is not yet completed, I can share with you some preliminary findings. Taxpayers seem reluctant to use the competent authority process because they feel that the process is inordinately long and costly, that the competent authorities are not always successful in resolving cases, and that foreign tax officials may retaliate by initiating audits on their foreign affiliates.

These are all valid concerns. I am confident, however, that the task force recommendations will significantly minimize these concerns.

Senator ABDNOR: Revenue Procedure 82-29 specifically states that the U.S. competent authority may "initiate" negotiations in any situation to protect United States economic interests. How often, and under what circumstances, have such actions been initiated?

Mr. EGGER: The protection of U.S. economic interests is normally accomplished through compliance with the IRS revenue rulings and the income tax regulations, previously mentioned.

Because of this, the U.S. Competent Authority has rarely had the need to initiate negotiations to protect such interests. Nevertheless, the U.S. Competent Authority will initiate negotiations in any situation where U.S. interests are in jeopardy, and where there are no otherwise available or established means to protect such interests.

Again, the task force is investigating the extent of the compliance with the revenue rulings and regulations, and will make recommendations to further enhance such compliance.

UNITARY TAXATION

Senator ABDNOR: The final report of the Worldwide Unitary Taxation Working Group was discussed during a September 21, 1984, hearing before the Subcommittee on International Economic Policy, Senate Committee on Foreign Relations. Treasury's Acting Assistant Secretary for Tax Policy testified that the states' voluntary adoption of the report's three principles -- water's edge limitation, federal tax administration assistance to state tax authorities, and competitive balance for domestic and multinational firms -- was the method preferred by the Reagan administration to resolve this issue. However, if appreciable progress was not made by states in voluntarily adopting these principles by July 31, 1985 Treasury was to be prepared to introduce federal legislation to resolve the unitary tax issue.

What would be the nature and scope such federal legislation and how would it resolve the unitary tax issue?

Mr. EGGER: Federal legislation to curb the use of the worldwide unitary taxation method by states is a matter of national policy, and therefore, this inquiry may be best addressed by my colleagues with the Treasury Department. However, from a tax administration viewpoint, the Internal Revenue Service has certain responsibilities to assist the states which adopt the water's-edge approach to unitary taxation as contained in the Final Report of the Worldwide Unitary Taxation Working Group. These responsibilities are in conjunction with an IRS strategic initiative for pursuing cooperative efforts with states and include establishing a communication system so that states may request the examination of taxpayer's tax return for potential international issues, providing IRS international issues training for state tax instructors, and providing assistance in conducting pricing studies of mutual interest to the IRS and the states.

Further, legislation is to be introduced which would require reporting by taxpayers of its tax liability including the method of calculation for each state in which it operates. This reporting would be made on a disclosure worksheet and would be shared with states not requiring the use of the worldwide unitary method.

The Service expects to conduct the international issues training during July and August 1985. Proposed legislation also has been drafted on the domestic disclosure worksheet, and public comments will be solicited in the near future.

Senator ABDNOR: How does IRS characterize the states' progress in voluntarily adopting the three principles outlined in the Working Group report?

Mr. EGGER: Of the states which were using the worldwide unitary method of taxation, three have repealed the method and others have the matter under consideration. However, as to an evaluation of the progress made, the Treasury Department would be in a better position to answer this inquiry.

WITHHOLDING TAX SYSTEM

Senator ABDNOR: Foreign investors who earn certain types of U.S.-source passive income (dividends, royalties, etc.) are normally subject to a 30-percent withholding tax on such income. That tax can be reduced or eliminated however, if the investor claims residence in one of the 34 countries which has an income tax treaty with the United States. Since investors themselves certified their foreign residences, however, IRS and the Congress suspected that persons not entitled to such tax treaty benefits were claiming residence in tax treaty countries and receiving the benefits. In this regard, IRS estimated that such improper claiming of treaty benefits was costing the Treasury hundreds of millions of dollars annually. Consequently, the Congress included Section 342 in TEFRA. This section required the Department of the Treasury to establish new procedures by October 1984 to assure that tax treaty benefits accrue only to qualified persons. What is the status of the new procedures?

Mr. EGGER: On September 10, 1984, we published in the Federal Register regulations proposing a certification system. This system requires, in general, that before a beneficial owner of income can secure the reduced withholding rate stipulated in the relevant tax treaty, he must file with the withholding agent a certificate of residence from the competent authority of his country of residence. The certificate of residence would state that the beneficial owner is a resident for purposes of the country's tax laws and is, thus, entitled to the rate specified in the treaty between the country and the United States.

A public hearing on the regulations was held on February 22, 1985. As measured by the comments received, the certification system is highly controversial. Numerous commentators perceive the system to be administratively burdensome and harmful to foreign investment in the United States. We are currently studying the comments and considering various ways to streamline the procedures and ameliorate the problems raised. In particular, we are considering some of the proposals involving foreign financial institutions holding stock or securities in their own names but for the benefit of their customers.

An alternative to the certification system is the refund-certification method. This would require withholding on payments at the full statutory rate of 30 percent regardless of the country of residence. A beneficial owner entitled to treaty benefits would have to file a claim for a refund of the excess tax withheld, attaching in support of his claim a certificate of residence or other evidence supporting his claim of residence. Despite the possible advantages of the refund-certification system from a tax collection standpoint, such a system would result in delay of reduced withholding for persons entitled to treaty benefits and could cause administrative problems for the Service due to the anticipated volume of refund requests.

Senator ABDNOR: How will the new procedures work? If a certification is required, who will make the certification?

Mr. EGGER: The proposed procedures require that a new Certificate of Residence form or similar statement which meets the certification requirements be filed with the withholding agent by foreign recipients claiming tax treaty benefits, except those receiving certain de minimis payments of less than $50 per calendar quarter. This Form 8306 calls for a statement by the foreign competent authority under the relevant tax treaty (or such other governmental office of the foreign country that customarily provides statements in lieu of the competent authority) that the foreign recipient, who must be the beneficial owner (i.e. not a nominee or any person acting in a similar capacity) of the item of income in respect of which a Form 8306 is filed, is a resident of the competent authority's country. Failure to obtain such s statement would result in the withholding agent withholding U.S. tax at the statutory 30% rate. Residents of a treaty country could claim a refund for overwithholding if the foreign competent authority subsequently supplied the required statement. In the case where the foreign country does not provide certifications of residency, an alternative method of verifying a foreign recipient's residence may be established with U.S. approval.

Senator ABDNOR: Besides reducing improper tax benefit claims, what other benefits will result from the new procedures?

Mr. EGGER: As mandated by Congress, the proposed procedures are designed to prevent nonresident aliens who are not actually residents of countries having tax treaties with the United States (or who are residents of countries having "less favorable" tax treaties with the United States) from establishing nominee accounts or post office boxes in countries having such a tax treaty (or a more favorable tax treaty) for the primary purpose of qualifying for the tax treaty benefits. However, they may have a peripheral effect on the establishment of residency in a foreign country for the sole purpose of securing treaty benefits.

Senator ABDNOR: During hearings in 1982 and 1983 before the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, the improper use of foreign addresses to evade U.S. taxes was discussed. Specifically, it was noted that a potential exists for U.S. taxpayers to use a little known loophole in Section 861 of the Internal Revenue Code. This provision allows persons having foreign addresses to receive interest income from U.S. banks and savings and loans associations free of tax or of reporting of the income to IRS. Therefore, a U.S. citizen who is able to establish a foreign address could use the provision to evade taxes without the risk of being identified by the IRS.

Has IRS estimated the number of persons earning such interest income and the amount of foregone tax revenue?

Mr. EGGER: Due to the absence of any current requirement to report Section 861(a)(1)(A) interest, the Internal Revenue Service has no exact data on the number of persons earning such income or the amount of tax revenue being foregone. The Service is presently drafting regulations to require the reporting of this income.

Senator ABDNOR: Is IRS developing procedures to prevent U.S. taxpayers from evading taxes in this manner?

Mr. EGGER: We have existing regulations requiring persons who claim to be foreign persons resident abroad to certify their foreign status under penalties of perjury in order to received deposit interest free of tax inside the United States. In addition to providing the certification, a recipient of deposit interest must provide the recipient name, address, and taxpayer identification number (if any). The certification statement and the other required information must be submitted to the payor on a Form W-8 or on a substantially similar form. These procedures are required under § 1.6049-5 (b) (2) (iv) of the regulations.

Senator ABDNOR: Section 127 of the Tax Reform Act of 1984 repealed the 30-percent tax on U.S.-source interest paid to foreigners. The repeal generated such concern within the Congress over the possibility that U.S. taxpayers could take advantage of the provision to escape U.S. taxes on their interest

income. However, Treasury and IRS were to implement procedures to prevent such abuse/evasion.

What actions has IRS taken to address the problem of U.S. citizens taking advantage of the repeal of the 30 percent tax?

Mr. EGGER: We are reviewing our examination and criminal investigation guidelines and procedures to emphasize techniques for the detection of U.S. persons holding debt instruments, such as bearer bonds, which lend themselves to tax avoidance/evasion.

Senator ABDNOR: How successful have these actions been?

Mr. EGGER: It is too early to say. The affected returns are just being filed.

Senator ABDNOR: What steps does IRS take to assure that investors are properly complying with the regulations/ procedures?

Mr. EGGER: Our primary means of assuring investor compliance with the regulations is through our examinations of the payers of the income. Payments to foreign persons are subject to withholding with certain exceptions; however, to qualify for an exception generally requires a specific action by the payer. In our examinations, the fulfillment of actions necessary to exempt reporting are scrutinized.

FOREIGN ACCOUNTS AND FOREIGN TRUSTS

Senator ABDNOR: Starting with the 1983 tax year, part III of Schedule B, Interest and Dividend Income, was expanded to ask persons to write the name of the foreign country if they had a foreign bank or other securities account or were involved in a foreign trust.

Now that IRS has had some time to gain experience with foreign investing, has IRS given any consideration to more prominently positioning on individual income tax forms the questions that IRS maintains must be answered on foreign accounts and trusts?

Mr. EGGER: No. We feel that the only location for the foreign account and trust questions that would be more prominent than the present location would be on Form 1040 itself. Severe space limitations on From 1040 would prevent us from adding questions to that form without removing other important information needed by individuals to determine properly their correct tax liability.

Senator ABDNOR: Recognizing that space on tax forms is extremely valuable, does IRS believe the questions it does ask on Schedule B sufficiently cover the information it needs to know?

Mr. EGGER: The answers to the questions, coupled with other forms, such as 3520, 3520A, and 90.22-1 which are required to be filed when answers are affirmative, are sufficient.

Senator ABDNOR: To what extent do taxpayers receiving interest and dividends ignore IRS instructions that taxpayers must fill out foreign account information (Part III) if they received more than $400 of interest or dividends or had a foreign trust? Would a penalty provision help IRS ensure that individuals supply the requested information?

Mr. EGGER: Statistics are not maintained for the number of taxpayers who failed to answer the foreign account information. However, 11,038 taxpayers answered the questions affirmatively and provided the name of the foreign country involved in fiscal year 1984. We would welcome a penalty provision to help ensure that individuals supply the requested information.

IRS/SOCIAL SECURITY ADMINISTRATION COOPERATION COMPLIANCE EFFORTS

Senator ABDNOR: To insure compliance in the reporting of income, deductions, and credits by related individuals, the Social Security number of both parties is important to the IRS to facilitate timely association of the returns. This is particularly important in cases where items on separate returns filed by spouses or former spouses are related. For example, it seems incongruous that in the 1982 tax year, $3.0 billion was listed on returns as alimony paid but only $1.9 billion was reported as alimony received.

What is IRS' position on requiring both spouses to report on his/her return the Social Security number of the other spouse?

Mr. EGGER: The IRS position is that both spouses should be required to report the Social Security numbers of the other spouse on their tax returns to facilitate tax administration. The Deficit Reduction Act of 1984 provides the IRS the authority to require the former spouse's SSN on the return of the alimony payer. Accordingly, this will be required on tax year 1985 and subsequent Forms 1040.

Senator ABDNOR: Can IRS estimate the extent to which taxes are lost because of this type of reporting problem?

Mr. EGGER: Estimates can be provided in those areas in which research projects have been completed. For example, it is estimated that for tax year 1985 there will be a tax gap of about $1 billion due to the incorrect reporting of child care expenses/income, which the IRS cannot efficiently detect because we do not have statutory authority to require SSN's to enable us to

conduct computerized payor/payee matching programs. On the basis of another study, it is also estimated that in tax year 1985 there will be approximately $323 million in underpaid tax due to incorrect reporting of mortgage interest paid to individuals, primarily involving take-back mortgages.

However, by far the largest amount of tax gap, which could be efficiently addressed if SSN's were required, involves dependency exemptions. Tax year 1979 TCMP data projected to tax year 1985 indicates that exemptions for some 6.5 million children will be incorrectly deducted on tax returns. Projected 1979 TCMP data also indicates a total of some 780,000 parents (or 37 percent of all exemptions for parents) would be claimed incorrectly on their children's 1985 tax returns, frequently because more than one child claimed the same parent or because the child (taxpayer) provided less support than the parent received from Social Security or other sources. Based on these projections, the tax gap for these incorrect exemptions is estimated at $1.5 billion for tax year 1985. Requiring the listing of SSN's for exemptions on tax returns would enable the IRS to identify duplication of exemptions and to match exemptions to Social Security beneficiary rolls.

The use of SSN's on tax returns for exemptions for children would also detect duplication of such exemptions (particularly prevalent in divorced and separated spouse situations) as well as enabling the IRS to match to welfare rolls to identify cases in which non-custodial parents, who are delinquent in paying child support, continue to claim their children even though the children (and the custodial parent) may be on welfare. (It should be noted that USDA regulations, for example, require SSN's from all members, including infants, of households receiving food stamps.) SSN's for exemptions will also allow the IRS to determine if children are filing their own tax returns reporting unearned income and incorrectly deducting the zero bracket amount (because their parents also claim their exemptions).

Senator ABDNOR: What action is IRS currently taking to correct this type of problem?

Mr. EGGER: We have had a program in existence for the past several years that identifies married taxpayers filing separately who are not consistent in the itemized deductions and/or zero bracket amount elections on their separate returns. This program also identifies married taxpayers who are duplicating dependents and deductions claimed on their spouses separate returns.

As part of the implementation of the Deficit Reduction Act of 1984, a computer program will be developed to identify 1984 and subsequent Forms 1040, (U.S. Individual Income Tax Returns) involving alimony payments and receipts. A computer

match will be made to see if the amount deducted by the payer was reported by the payee. We will examine several thousand of these returns depending on the scope of the non-compliance.

COMPLIANCE EFFORTS

Senator ABDNOR: IRS recently decided to no longer require persons who take the child care credit to identify to whom they paid the money.

Did IRS study the deterrent value of providing the names/social security numbers of recipients before it changed the form?

Mr. EGGER: Yes, IRS considered whether the removal of the names and social security numbers of recipients of child care payments from Form 2441 would adversely affect compliance.

Our decision to remove the information from the form was based on two reasons; we wanted to significantly simplify the form used to figure the credit for the child and dependent care expenses, and we wanted to include the credit on Form 1040A.

In late 1982, as part of the Service's ongoing effort to reduce the reporting burden and to simplify the forms for all taxpayers, we reviewed specific forms that had the potential of achieving significant burden reductions. Form 2441 was one such form. Therefore, it was decided that for 1983 we would look into simplifying that form by reformatting it and eliminating items that were not essential to the processing of the tax return or did not have practical utility to any ongoing IRS program.

The proposal was reviewed by the Tax Forms Coordinating Committee, which is comprised of members from each functional component within the Service. The Committee determined how the various functions in IRS used certain information on Form 2441.

Based on the information received by the Committee, it was concluded that although the names and social security numbers were helpful to the Service during the examination of tax returns where the credit was an issue, they were not part of an ongoing Service program that used the information. Therefore, it was decided to remove the information from the Form 2441 for 1983.

At that time we were also considering various proposals that would allow more taxpayers to use the shorter Form 1040A, instead of Form 1040. One proposal included adding the credit for child and dependent care expenses to Form 1040A.

We had received a number of requests from various organizations to add that credit to Form 1040A. The organizations felt that many working women who paid for child care were entitled to the credit but may not have been claiming the credit because they filed Form 1040A and not Form 1040. We estimated that at least 600,000 Form 1040 filers would be able to use Form 1040A if we added this credit to the form.

The decision to remove the information from Form 2441 made it easier to include the child care credit on Form 1040A.

Senator ABDNOR: How does IRS decide whether the use of a social security number is worth requiring on a tax form, particularly from a compliance standpoint?

Mr. EGGER: In determining the "worth" of requiring social security numbers on a tax form, the first question that must be addressed is whether the Service has the authority to require the number. For instance, under section 6109 of the Code, IRS has broad authority to require taxpayers to include their own social security numbers on any return, statement, or document filed with IRS for purposes of securing proper identification of the taxpayer. We do not, however, have the same broad authority to require the social security number of one taxpayer on the tax return of another taxpayer. For example, we recently considered including on Forms 1040 and 1040A a requirement that taxpayers provide the Service with the social security numbers of their dependents. The information would have been used for compliance purposes to identify duplicate dependency exemption cases, as well as for certain statistical programs. However, in General Counsel Memorandum (G.C.M.) 39319, dated January 8, 1985, we were advised that the Service does not have the authority to require taxpayers to report the social security numbers of their dependents on their returns because of the limitation contained in section 6109(b)(1) of the Internal Revenue Code.

If the Service does have statutory authority to require the use of social security numbers, or other information, on tax returns, the reporting burden on the public must be considered. While an actual "dollars and cents" approach cannot be used because this information is not always available, the benefits and costs to the Service must be weighed against the burden placed on the public.

Section 3508 of the Paperwork Reduction Act of 1980 states that before approving a form, OMB shall determine whether the collection of information by an agency is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility. In section 1320.7(q) of OMB's regulations implementing the Paperwork Reduction Act, "practical utility" is defined as the actual, not merely the theoretical or potential, usefulness of information to an agency, taking into account its accuracy, adequacy, and reliability, and the agency's ability to process the information in a useful and timely fashion. In emphasizing the actual usefulness of information over its theoretical or potential value, OMB apparently is not concerned with the deterrent or psychological value of collecting information from the public. In reviewing and approving the tax forms, OMB has insisted that we justify the information requested on the forms by demonstrating the actual needs and uses for this information. Therefore, the Service has made every effort to remove information requested on the tax forms where there is no program in place to actually use the information.

TAXATION OF SOCIAL SECURITY BENEFITS

Senator ABDNOR: The Social Security Amendments of 1983 provide that taxable income include up to one-half of Social

Security and Railroad Retirement (Tier 1) benefits received by taxpayers whose income exceeds certain levels ($25,000 for single taxpayers, $32,000 for married taxpayers filing jointly). In this regard, Social Security sent out 41 million notices to advise beneficiaries of the amount of benefits paid. Further, Social Security said that it expects about 9.2 million beneficiaries to inquire about the taxability of their benefit amounts.

What guidance does IRS offer such taxpayers?

Mr. EGGER: We have closely coordinated the implementation of the Amendments with the Social Security Administration and the Railroad Retirement Board with whom we have joint agreements outlining the responsibilities of each agency in helping the public deal with the possible taxability of its Social Security income. The Service prepared an aggressive action plan to meet the anticipated impact of the Social Security mailout. This included the development of publications (Publication 703), notices (Form 1099S), and multi-media information modules to assist taxpayers. We authorized field offices to increase staffing to handle additional inquiries as they materialized. We have had only slight increases in contacts arising from the Social Security Amendments of 1983. We attribute this to our information efforts.

Senator ABDNOR: Is there any way to minimize the amount of disruption that Social Security expects to face now or in the future?

Mr. EGGER: The Service will continue to do all it can to apprise taxpayers of the implications of the Social Security Amendments of 1983, especially through its Taxpayer Information program. To the extent necessary, we will work with the Social Security Administration and the Railroad Retirement Board to coordinate our efforts.

Senator ABDNOR: On January 16, 1985, IRS announced that it would waive tax underpayment penalties this year for recipients of Social Security who failed to take their benefits into account when making quarterly payments to the federal government. IRS said the waiver would cover only the 1984 tax year and that Social Security recipients would have to include the taxable portion of their benefits in estimated quarterly payments made for 1985.

Did the notices that Social Security sent out advise taxpayers about the possibility of paying quarterly taxes. Is it possible that those who have to pay quarterly taxes might not realize it?

Mr. EGGER: No, the SSA-1099, Social Security Benefits Statement, did not contain information on estimated tax payments. However, IRS Notice 703 (August 1984) was included with each SSA-1099 sent to recipients. Notice 703 directed taxpayers to obtain Publication 915, Tax Information on Social Security Benefits (and Tier 1 Railroad Retirement Benefits), for more information on the taxation of benefits. A section explaining estimated tax responsibilities was included in the

publication. If the taxpayer needed further information, it could be obtained by contacting the toll-free number(s) listed on the notice or by securing Publication 505, Tax Withholding and Estimated Tax, from one of our offices.

Since there was a possibility that benefit recipients might not be aware of their responsibility to file estimated taxes, the 1985 requirements were described in several media releases this filing season. The releases provided general information on who was required to pay estimated tax and how this impacted on Social Security recipients. Also, as part of our implementation plan, we coordinated this issue with the American Association of Retired People (AARP). IRS and AARP jointly developed a series of four articles on Social Security issues for AARP's national publication, The News Bulletin. Two of these articles provided information on estimated tax.

Senator ABDNOR: Does IRS plan to exempt from penalty those Social Security beneficiaries who do have taxable income but who report incorrect amounts or no amount at all?

Mr. EGGER: IRS does not have the authority to exempt Social Security beneficiaries from penalties for underreporting of taxable SSA benefits. However, such penalties may be waived where the taxpayer can show the failure to report the income was due to reasonable cause and not willful neglect. The IRS issued several news releases, including newspaper and live radio spots. IRS Notice 703 was mailed to all SSA beneficiaries; Publication 915 was developed; and all the tax packages carried a prominent message regarding the taxation of SSA benefits. Because we feel this issue was very well publicized, any decision to waive the penalty due to underreporting (or not reporting) of SSA benefits will only be considered on a case by case basis.

Senator ABDNOR: GAO has reported in the past that there are some people who do not pay their Social Security self employment taxes, yet are able to gain credit--for Social Security purposes--for the earnings upon which the taxes were not paid. Conversely, GAO has also developed some data for 1979 to show that there are some self-employed persons who report their earnings very late (after the tax reporting deadline for filing) and pay their Social Security taxes, but are not entitled to receive earnings credit for Social Security purposes. Are any current data available to estimate the extent of these problems?

Mr. EGGER: Internal Revenue Service has no current data available that would quantify the number of self-employed persons or the dollar amount of self-employment taxes involved.

Senator ABDNOR: Have IRS and Social Security explored any remedies to these problems?

Mr. EGGER: In both of the above issues GAO found no fault with either IRS's or SSA's procedures for the processing, collecting, and recording of self-employment earnings records - as required by the Internal Revenue Code and the Social Security Act.

In regard to the allowance of self-employment earnings for credit towards Social Security benefits when the related tax has not been paid, GAO recommended that Section 205(c) of the Social Security Act be amended to preclude such credit unless the tax has been paid. Such legislation was proposed in both the 95th and 96th Congress but no action taken. GAO indicates that there has been no further consideration of this proposal since the 96th Congress.

To date we are unaware of any legislative proposals from either IRS, SSA, or GAO to resolve the apparent inconsistency between the Internal Revenue Code regarding the collection of Social Security taxes and the Social Security Act regarding the time limitation that earnings may be credited.

IRS and SSA are in the process of establishing a joint work group to consider various issues in the reporting and recording of self-employment earnings records. We will add these two issues to that joint work group's agenda.

LARGE LIMITED PARTNERSHIPS

Senator ABDNOR: Large limited partnerships, particularly in the oil and gas and real estate fields, have proliferated in recent years. Also, recent industry publications have described the increasing rise of publicly traded limited partnerships. Several of these partnerships were created through the disincorporation of existing corporations.

Do limited partnerships with a large number of limited partners present serious audit and administrative problems for IRS?

Mr. EGGER: Prior to TEFRA legislation, limited partnerships with large numbers of limited partners presented the Service with serious audit and administrative problems. The most serious problem was the management of huge numbers of investor returns. The TEFRA legislation has helped the Service by enabling determinations to be made at the partnership level without having to make separate determinations on each partner's return.

Our experience with managing returns falling under the TEFRA legislation is thus far limited. While we anticipate great improvement, we at this juncture do not know whether all of our problems have been solved.

Senator ABDNOR: Do the partnership audit procedures contained in TEFRA alleviate these partnership examination problems? Is additional legislation needed?

Mr. EGGER: The TEFRA legislation has helped the Service by enabling determinations to be made at the partnership level without separately having to make determinations at each partner's level.

Our experience with managing returns falling under the TEFRA legislation is thus far limited. While we anticipate great improvement, we at this juncture do not know whether additional legislation would be needed.

Legislation is needed to enable investor penalties under Subtitle F to be determined at the partnership level as well. At present, IRC section 6231(a)(3) limits the definition of partnership item to Subtitle A income tax issues.

Senator ABDNOR: Does the fact that some partnerships have units of ownership in the partnership freely traded on the stock exchanges add to the IRS' tax administrative burden? Can such partnerships properly account for and allocate profits or losses to the partners when units change hands frequently during the tax year?

Mr. EGGER: Limited partnership interests are, overwhelmingly, long term investments that are not usually traded. Although secondary markets do exist for some promotions, this is still the exception rather than the rule. Large publicly traded partnerships can properly account for and allocate profits or losses to the partners when units change hands frequently during the tax year. Of course this is difficult to accomplish, but the burden for doing this is upon the partnerships themselves and therefore does not impose a significant burden upon the Service.

The partnerships are aided in this recordkeeping by sophisticated computer programs. TEFRA legislation greatly enhanced the ability of the Service to audit the partners of large partnerships insofar as the treatment of partnership items is concerned by providing that the tax treatment of any partnership item shall be determined at the partnership level.

We have, however, experienced administrative problems with certain types of large royalty trusts having ownership interests or units that are freely traded on stock exchanges. These trusts are not covered by the TEFRA partnership legislation and cannot be classified as associations taxable as corporations. This means that the determinations must be made at the investor level, resulting in the same type of burdens that we had with pre-TEFRA partnerships.

The Tax Reform Act of 1984, by providing that corporations must now recognize the gain of the distribution of appreciated property to their shareholders, helps alleviate our problems somewhat. The change reduces the motivation of corporations entering into this type of trust arrangement to eliminate taxes at the corporate level.

However, the Service will still have considerable administrative burden involving trusts for which this change is not a factor.

Senator ABDNOR: To what extent are large limited partnerships included in IRS' regular examination cycles? Are examinations of these entities avoided because of their difficult and time consuming nature?

Mr. EGGER: We do not avoid auditing large limited partnerships.

Most of the large limited partnership returns that are filed tend to fall into categories that we feel are tax shelter in nature. Large limited partnerships are included in the Tax Shelter Program to the degree that we feel there may be abusive tax shelter issues present.

The partnerships we examine in our general program tend not to be large limited partnerships. They tend to be smaller partnerships. We do audit the large ones that are in need of audit but do not fall into the shelter program.

Senator ABDNOR: How many large partnerships (more than 35 partners) did IRS examine in 1984? How many partners were involved? What was the amount of any proposed adjustments? How much in additional taxes was collected?

Mr. EGGER: Our current management information reports do not distinguish between large and small partnerships.

We examined 6,606 partnerships in Fiscal Year 1984 in the Tax Shelter Program. We examined approximately 97,000 individuals in Fiscal Year 1984 in the Tax Shelter Program, most of whom were partners in one or more partnerships. We do not know how many of these individuals were partners in large partnerships.

Senator ABDNOR: Are there legitimate business reasons for the proliferation of large limited partnerships, particularly the conversion by some corporations to limited partnerships, or is their primary purpose the avoidance of the corporation income tax?

Mr. EGGER: In general, the primary benefit to direct participation programs, including limited partnerships, is the flow through of tax losses and investment credit to the investors. The law allows partnerships great latitude in allocating the results of operations among the partners, provided that the principal purpose of the allocation is not to avoid or evade the Federal income tax. This latitude is a legitimate reason for the existence of the partnership form of business.

We think proliferation of large partnerships is due not to the greater latitude allowed, but rather due to the flow through of the losses and credits that is allowed. We feel that avoidance of the corporation tax is not usually the primary purpose.

Senator ABDNOR: Has IRS estimated the tax revenue impact on the Treasury as a result of these partnerships escaping corporate level taxation?

Mr. EGGER: We have not determined the revenue impact of large partnerships avoiding corporate taxes.

TAX COURT BACKLOG

SENATOR ABDNOR: IRS' Office of Chief Counsel (OCC) performs a number of functions. OCC is responsible for providing legal advice to the IRS, litigating tax cases in the U.S. Tax Court, handling taxpayers' administrative appeals, issuing letter rulings and revenue rulings, and developing tax regulations to implement the Internal Revenue Code. Tax Court backlogs are growing and have now reached about 60,000 cases. What action has been taken to deal with this problem?

MR. EGGER: As of the end of FY 1984, the Tax Court's inventory consisted of 63,598 cases, an increase of more than 360% during the past decade. This increase in inventory is not surprising, considering that receipts have increased by 380% during the same period. Cases now before the Court involve proposed deficiencies of over $12 billion. Although staffing and budget constraints have placed limits on the extent we can respond to the increased workload, cases continue to move through the system in an orderly fashion. Last year, we closed 48% of the Tax Court cases that were in inventory at the beginning of the year, down only slightly from the 52% closing rate of 1974. We have increased the efficiency with which we process cases by:

Allowing Appeals Officers to retain settlement jurisdiction for a longer time after a case is filed. See, Rev. Proc. 82-42. Last year, settlements accounted for 80% of all Tax Court disposals, an increase from the 74% settlement rate in FY 1974;

Eliminating paperwork and making greater use of nonattorney personnel, especially in the processing of small cases and tax shelter cases; and

Centralizing the handling of cases involving common tax shelter promotions, and severing unrelated issues in multi-issue cases.

SENATOR ABDNOR: How many cases does each attorney have? Is this reasonable?

MR. EGGER: At the end of last fiscal year, we had 769 attorneys (including managers) in our field offices, with an average of 83 Tax Court cases per attorney. Over the past 10 years, Tax Court caseload per attorney has increased by 207%. On average, each field attorney is responsible for cases involving over $1.5 million in proposed deficiencies. Tax Court work accounts for only a part of a field attorney's workload. These attorneys are also responsible for a large number of general litigation (primarily collection, bankruptcy, and summons enforcement), refund litigation, and criminal cases. Staffing and budget constraints have placed limits on the extent to which we can respond to increased inventories.

APPEALS

SENATOR ABDNOR: Taxpayers are increasingly bypassing Appeals and filing directly with the Tax Court. Why, and what steps is IRS taking to deal with this problem?

MR. EGGER: An increasing percentage of Tax Court petitioners are filing petitions in response to deficiency notices issued by examination (district director or service center) personnel. During FY 1984, 89% of Tax Court receipts involved deficiency notices issued by examination. In FY 1979, this percentage was 82%, and in FY 1974 it was 72%. We share your concern that an increasing number of taxpayers are bypassing a prelitigation opportunity to have their cases settled by Appeals.

Taxpayers bypass Appeals for a variety of reasons. Some bypass Appeals in order to avoid preparing a protest memorandum. Others bypass Appeals in order to ensure that the burden of proof on any new issue raised by the Commissioner will be on the Commissioner. (If a new issue is raised by Appeals in a nondocketed case, the burden of proof in a later Tax Court case is generally on the taxpayer; the burden of proof is on the Commissioner if new issues are raised after the case is docketed. See, T.C. Rule 142.)

The failure of more taxpayers to utilize the Appeals process is perplexing in view of Appeals' excellent record in settling nondocketed cases. Last fiscal year, Appeals settled 85% of their nondocketed cases. These settled cases involved over $1.7 billion. We are actively promoting the availability of the Appeals settlement procedures.

Taxpayers who bypass Appeals at the administrative stage are referred to Appeals after their case is docketed. Where a petition results from a deficiency notice issued by examination personnel, Rev. Proc. 82-42 requires the case to be referred to Appeals for consideration of settlement. The procedures established in Rev. Proc. 82-42 allow Appeals to retain jurisdiction over the case as long as progress toward settlement is being made, or until the case appears on the Court's Trial Status Request.

SENATOR ABDNOR: IRS' appeals and the legal offices have been working for the last several years to develop new management information systems. What is the status of these efforts? When will the systems be fully implemented?

MR. EGGER: We currently have a number of fully operational systems and are continuing development on others.

Management Information systems for the Interpretative and Employee Plans and Exempt Organizations Divisions were implemented in 1983. The data for these systems is processed on mini-microcomputers.

A management information system for the Legislation and Regulations Division was implemented in 1984. The information from this system is provided to Counsel, IRS, and Treasury management and the data for this system is processed on the Univac computer at the Treasury Department.

The Counsel Automated Tracking System (CATS) is a computerized on-line, legal case tracking system which is being developed to allow input of data via on-line data terminals in each Chief Counsel office. The CATS system will maximize the use of ad hoc queries and

minimize paper generation and the time associated with filing and retrieving paper. Data input is accomplished in each originating/ responsible office with all data being immediately available to any authorized user. This eliminates the need for legal docket cards, index cards, and the present requirement for mailing computer input documents around the country. Access to data is strictly controlled by user identification security methods.

CATS Tax Litigation Stage I software has been developed, installed and is operational for Mid-Atlantic Region offices and the National Office. Stage I will be expanded to the Southwest Region in June 1985 and will be implemented nationwide as soon as the full complement of terminals are procured. This full expansion is expected to be completed between February and June 1986. A partial complement of terminals will be in each Chief Counsel office prior to the end of FY 1985 and will allow partial support of CATS by all offices except Mid-Atlantic and Southwest Regions where full support will be available. Tax Litigation Stage II software development is in process and has a September 1985 implementation date.

CATS development for the two Technical Divisions (Individual Tax and Corporation Tax) has been accelerated to allow better utilization of ADP funds. Full implementation for Individual Tax, Corporation Tax, General Litigation and Criminal Tax functions is projected for FY 1986. All remaining functions should be completed by the end of FY 1987.

The Appeals portion of the Counsel Automated Tracking System (CATS) was cancelled this fiscal year. We were experiencing delays in software development and equipment acquisitions, and the performance of the equipment under test conditions did not meet our expectations. Because of these problems and the Service's need to reduce ADP expenditures in fiscal years 1985 and 1986, it was decided that to continue the project as planned would not be feasible nor cost beneficial.

Savings will be substantial by cancelling the Appeals portion of CATS and replacing this project with a much less costly system using micro and mini computers. The total equipment and support costs required for the replacement system in fiscal years 1985 and 1986 are estimated at $818,000, which is considerably less than the $3,249,000 that would have been required for CATS in those years. The savings in fiscal years 1987 through 1989 are even more impressive in that the replacement system is estimated to cost $414,000 while CATS would have cost $4,625,000.

The replacement system will provide Appeals with case tracking and tax computation capabilities in additon to basic management information. However, current plans for the system do not include the type of information, i.e., tax return workload by type of tax and related production rates, that will be required for the Servicewide resource allocation model now being developed.

IMPROVEMENT OF REGULATIONS

SENATOR ABDNOR: GAO issued a report in December 1983 (GAO/ GGD-84-12) which suggested ways to improve the regulations development process. How is that process working today?

MR. EGGER: The Internal Revenue Service and the Treasury Department have devoted considerable time and attention to improving the regulation development process. The automated case tracking system suggested in the GAO report has been developed and implemented. It is generating management information reports that enable the Service to identify projects with extensive time lags to which attention needs to be devoted. The Service and Treasury have also implemented steps to provide earlier input into the regulation process by Treasury attorneys, and have worked jointly on some projects, particularly those necessitated by the Tax Reform Act of 1984, to insure early publication. This resulted in publications on 47 projects involving the 1984 Act during the last five months of 1984. Although there has been progress, assuming continued significant new tax legislation, there is a limit to the progress that can be made in reducing the backlog of unpublished regulations.

USER CHARGES FOR PRIVATE LETTER RULINGS

Senator ABDNOR: The Administration, the Grace Commission, and others have, at various times, proposed that the IRS should charge for private letter rulings which are prepared for and issued directly to specific requesting taxpayers. What is the revenue potential of such an initiative? What additional costs would be incurred? If the revenue raised were devoted to improving the rulings process, what benefits could be expected?

MR. EGGER: In 1984 the Service issued 44,085 letter rulings. If a user charge of $100 per ruling were imposed (and such a proposal was included in the Administration's 1986 budget), the proposal would have yielded $4,408,500. To date, the Service has not made a detailed analysis of the impact of the proposal because of the fee schedule variations that could be considered. However, some increased costs, due to fee processing, are expected. The Service has not considered the possibility of applying this revenue to the ruling process. As a general rule, if additional revenue becomes available to the Service, Service officials would consider the needs of the various programs within the Service before deciding on the application of the additional funds.

OPPORTUNITIES TO CONSOLIDATE FIELD OFFICE FUNCTIONS

Senator ABDNOR: IRS extensive field office structure (7 regions, 10 service centers, 63 district offices, and numerous other small posts of duty) requires effective management to avoid duplication of responsibilities and functions. For example, regional offices, district offices, and service centers typically dedicate staff to such functions as disclosure, procurement personnel, facilities management, and problems resolution. Recently, IRS' Central Region studied the feasibility of consolidating regional, district, and service center personnel functions into one office. The potential may exist to consolidate other functions, particularly when offices are located close to each other.

To what extent has IRS studied the possibility of combining or consolidating the above functions?

Mr. EGGER: Two studies have been initiated recently to identify administrative processes that could be consolidated within metropolitan areas having multiple IRS offices. In addition to the Central Region Study the service has also instituted a National Administrative Activities Study to review potential consolidations in metropolitan areas in addition to identifying other administrative economies.

Senator ABDNOR: What is the outcome of these studies?

Mr. EGGER: Both studies are ongoing, however, they have identified consolidations which we are in the process of implementing. As a result of our national study we decided on March 8, 1985, to consolidate all Regional Office Personnel offices in the same metropolitan areas. This initiative will affect all seven (7) of our regional offices and is in the process of being implemented at this time. Full implementation of this organizational change will result in an estimated 15 staff years being saved through a reduction of duplication of skills, particularly in program management and clerical activities. Each of our regional offices is currently developing action plans to implement this consolidation. The Central Region Study has developed several other initiatives for consolidation which were approved for implementation within the Region on April 8, 1985. All clerical Personnel processes in metropolitan Cincinnati will be consolidated within the Service Center Personnel Office. Additionally, procurement activities and tax forms management for the entire region will be centralized within the Cincinnati Service Center. If these consolidations prove successful in Central Region they will be expanded to other Regions at a later date. Both of these study groups will continue their efforts over the balance of the fiscal year and we expect that further consolidations will be identified and implemented in the near future.

USE OF OVERTIME AND TEMPORARY HELP

Senator ABDNOR: In IRS' summary justification of its fiscal year 1985 funding estimates, $3.9 million in overtime was requested to enable personnel to collect $77 million in additional unpaid taxes. Can IRS provide estimates of the total overtime dollars it expects to pay for fiscal year 1986? What tax functions are involved?

Mr. EGGER: The budget for FY 1986 includes $41.1 million to compensate employees for overtime work, a decrease of $1.9 million from our FY 1985 funding level. Overtime is used to: process tax returns and issue refunds ($10.3 million), collect unpaid taxes ($16.8 million), examine tax returns ($2.1 million), and investigate tax fraud, including premium pay for special agents ($6.6 million).

Senator ABDNOR: Has IRS explored whether it would be better to expand its permanent positions rather than requesting overtime? Could temporary employees fill in for IRS' peak workloads?

Mr. EGGER: In light of present and prospective budget constraints, it is more advantageous and cost-effective in the short run to spend overtime dollars on experienced and productive employees already on our rolls than to incur the considerable expense of recruiting and training new employees. While costs are significantly reduced, productivity is also enhanced because of the substantially

higher yields generated by seasoned employees in comparison to those of new hires.

As a long range strategy, however, it would appear preferable to increase permanent staffing to a level that better reflects the revenue-producing potential of our workload and also minimizes the need for overtime work.

The Service makes extensive use of temporary and seasonal employees to help meet workload peaks. The majority of these employees are engaged in activities associated with processing tax returns in our ten service centers. Substantial numbers of temporary and seasonal employees are also engaged in non-field collection activities and in providing tax assistance to the public.

Senator ABDNOR: During the past year, the Office of Personnel Management has advocated the use of temporary staff in lieu of permanent staff as a cost-saving measure.

To what extent does IRS use temporary staff? Can IRS provide some trend data on its use of temporary help?

Mr. EGGER: IRS makes extensive use of temporary and seasonal employees in meeting workload peaks in processing tax returns and providing assistance to the public. We have also significantly expanded the use of temporary and seasonal employees in our non-field collection activities. Over eighteen percent of total IRS FY 1984 staffing was spent on temporary and seasonal employees. Forty-two percent of the staffing allocated to assisting the public during FY 1984 reflected temporary and seasonal employment, as did thirty-five percent of the staffing used in processing tax returns and seventeen percent of the staffing used in collecting delinquent taxes.

Temporary and Seasonal Staffing

	FY'80	FY'81	FY'82	FY'83	FY'84
Total IRS:	15,126	15,833	12,063	12,920	15,850
Tax Processing:	10,888	10,678	7,341	6,061	7,591
Collection:	494	1,289	1,354	2,522	3,241
Taxpayer Service:	2,118	2,051	1,447	1,689	1,846

(NOTE: Reductions in the numbers of temporary and seasonal employees in the tax processing and taxpayer service functions reflect overall staffing reductions in these areas.)

Temporary and Seasonal Staffing as a Percentage of Total Staffing

	FY'80	FY'81	FY'82	FY'83	FY'84
Total IRS:	17%	18%	15%	15%	18%
Tax Processing:	38%	39%	31%	30%	35%
Collection:	4%	10%	9%	14%	17%
Taxpayer Service:	38%	39%	33%	38%	42%

Senator ABDNOR: Does IRS foresee any adverse effects of making more use of temporary staff?

Mr. EGGER: We foresee no adverse impact in making greater use of temporary staff where the nature of the work, labor market conditions and organizational considerations make that a viable option. However, we would not want to risk jeopardizing the accomplishment of the IRS mission by infusing large numbers of additional temporary employees without thorough study. We believe that our performance evidences our willingness to utilize temporary and seasonal employees where this is cost-effective and where it contributes to a sound balance between effectiveness and efficiency.

Senator ABDNOR: Does IRS' workload lend itself to being subdivided into work that could be done by temporary staff?

Mr. EGGER: The Revenue Service periodically conducts workload studies and other organizational and occupational analysis in an effort to increase productivity and lower costs. An important objective of these studies is the identification of less complex work that can be broken out and assigned to lower-graded employees having less than the full range of professional or technical qualifications. In many instances, this lower-level work is found to be suitable for performance by temporary or seasonal employees and is assigned accordingly.

Some IRS occupations do not lend themselves to staffing on other than a full-time, permanent basis. For example, we believe that it would be unrealistic to attempt to recruit, on a temporary basis, for positions that are currently difficult to fill on a permanent basis (e.g., Internal Revenue Agents).

We will continue to explore the use of temporary staff, consistent with our overall objective of achieving our mission in the most cost-effective manner possible.

TAX-EXEMPT ORGANIZATIONS

Senator ABDNOR: IRS' July 1983 Income Tax Compliance Research Report disclosed that the gap for unrelated business income tax was $109 million in tax year 1981. This figure was estimated based upon a Taxpayer Compliance Measurement Program (TCMP) of certain 1973 and 1974 exempt organization returns. IRS is in the final phase of an expanded TCMP and tentative

estimates from this TCMP indicate that the unrelated business income tax gap may be lower than previously reported.

What is the status of the current TCMP? Are any changes in enforcement and monitoring policy anticipated in response to the results?

Mr. EGGER: First let me explain that we believe additional data is needed to measure the unrelated business income tax (UBIT) gap more precisely. We are planning a specific Form 990-T TCMP in the near future which will be designed to give us more pertinent and reliable data. Examinations for the expanded EO TCMP of returns filed in 1981 through 1984 were completed by March 31, 1985. Data from this study is being tabulated and will be available for analysis by the latter part of fiscal year 1985. The data will be used to update the Discriminant Function (DIF) Formulas used to select Form 990 and 990-PF returns for examination. The data will also be used to develop an EO Resource Allocation Model to maximize the compliance effect of our examinations. At this time, no changes in enforcement and monitoring policy are planned. When the final TCMP results are fully analyzed, necessary changes will be made.

Senator ABDNOR: What factors does the IRS attribute to the lower estimate of unreported unrelated business income tax? For example, does IRS believe the lower estimate is due to better enforcement on its part, increased awareness of the reporting requirements by the tax-exempt organizations, or an increase by these organizations in activities not subject to the unrelated business income tax?

Mr. EGGER: As I indicated before, we believe there is a need for more precise data in the area of unrelated business income tax. The initial estimate of unreported unrelated business income tax was based on the volunatry compliance levels determined from examinations of the 1973 and 1974, Form 990 and 990-PF returns of private foundations, public charities and social welfare organizations exempt under Code sections 501(c)(3) and 501(c)(4). The expanded TCMP survey of 1981 through 1984 returns that was just completed in March, 1985, included examinations of organizations exempt under Code sections 501(c)(3) through 501(c)(8) filing Forms 990 and 990-PF. Inasmuch as neither of the surveys specifically included Forms 990-T, it is difficult to assign a reason for any change in the unrelated business income tax gap with any degree of certainty.

Senator ABDNOR: Is the unrelated business income tax gap primarily due to underreporting, nonreporting of income, or excessive or incorrect deductions?

Mr. EGGER: Unforunaltely, we simply do not know. As I have mentioned, the EO TCMP surveys conducted to date were not designed to provide that type of information.

Senator ABDNOR: What specific measures does IRS have on going or have planned to close the estimated tax gap for unrelated business income?

Mr. EGGER: To improve overall compliance, the examination plans for exempt organizations, have in the past and will continue in the future, to emphasize the enforcement of requirements for filing timely Forms 990-T which report the correct amount of tax. We also plan to develop a TCMP survey of Forms 990-T, Exempt Organizations Business Income Tax returns, which will be designed to address the causes of the unrelated business income tax gap. The TCMP survey is planned to begin in fiscal year 1987 and cover returns filed in 1985 and 1986.

Senator ABDNOR: The Small Business Administration has labeled unfair competition between the non-profit sector and taxable businesses as a major emerging policy question for the 1980's. Sections 511 through 514 of the Internal Revenue Code impose a tax on the unrelated business activities of tax-exempt organizations in order to eliminate such unfair competition.

In applying the unrelated business income tax provisions of the Code, does IRS emphasize the relatedness of an activity to an organization's exempt purpose, or the similarity of the activity to commercial endeavors? How does IRS ensure that tax is truly levied on unrelated activities?

Mr. EGGER: In determining whether to apply the unrelated business income tax, section 513 of the Code requires the Service to consider the relatedness of an activity to an organization's exempt purpose. However, before subjecting an unrelated business to tax, section 512 requires that the business must be "regularly carried on". The regulations explain that this requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same basis as the non-exempt business endeavors with which they compete. Hence, business activities of an exempt organization will ordinarily be "regularly carried on" if they manifest a frequency and continuity and are pursued in a manner, generally similar to comparable commercial activities of non-exempt organizations.

An organization exempt under section 501(a) must file a tax return, Form 990-T, if it has gross income from an unrelated trade or business of $1,000 or more. This requirement helps ensure that tax is levied on unrelated business activities. To encourgage voluntary compliance, we conduct an examination program of exempt organizations' information returns, Forms 990, and tax returns, Forms 990-T. We also provide rulings to taxpayers on proposed transactions that may result in the application of the unrelated business income tax.

Senator ABNOR: What particular problems has IRS encountered in administering these code provisions?

Mr. EGGER: IRS has encountered a number of accounting and definitional problems in administering these provisions.

In the accounting area, for example, the facilities and personnel of an exempt organization are oftentimes used both to carry on exempt functions and to conduct unrelated trade or busi-

ness, thereby necessitating an allocation to each use. In Rensselaer Polytechnic Institute v. Commissioner, 732 F. 2d 1058 (2nd Cir. 1984) the Court held that an educational organization that used its fieldhouse facility for both exempt and taxable purposes was entitled to allocate its indirect expenses such as depreciation, between the exempt activity and the taxable activity on the basis of the actual hours the facility was used for each activity, rather than the total time the facility was available for use, thus, in our view, artificially increasing the allowable deductions.

An example of the definitional problems is the case of The American College of Physicians v. U.S. 743 F. 2d 1570 (Fed. Cir. 1984) involving the sale of commercial advertising in a medical journal published by an exempt organization. Although the Service has consistently taken the position that all commercial advertising in exempt organization periodicals is unrelated trade or business, the court determined that, in this case, the sale of advertising was related to the organization's exempt purpose. This decision would require the Service to evaluate the informational content of the advertising in a periodical on an ad by ad basis to determine which ads are related and which are not.

Senator ABDNOR: Has the tax been effective in eliminating unfair competition between exempt organizations with unrelated activities and taxable entities engaged in similar activities?

Mr. EGGER: In general, yes. In those instances in which an exempt organization engages in unrelated activities they are subject to a tax that equalizes the exempt organization with a taxable organization engaging in the same activity. In some cases the unrelated business tax could have dissuaded exempt organizations from engaging in unrelated activities and in other cases they have set up taxable subsidiaries to engage in such activities.

Although taxable organizations frequently allege that exempt organizations compete unfairly with them, the Internal Revenue Code excuses an activity from tax if it is "substantially related" to an exempt purpose, and Congress has not legislated a specific test or standard to determine what is unfair competition.

Even though some exempt organizations' related business activities are substantially the same as those that are conducted by taxable organizations, it is arguable whether these exempt organizations are competing unfairly.

Senator ABDNOR: Political Action Committees (PACs) are another type of organization which are exempt from taxation. Recent public commentaries have questioned the activities of tax-exempt PACs and whether some of them are being used for the private financial benefit of those in control. What is the extent of IRS administration of PACs?

Mr. EGGER: During calendar year 1984, our records indicate 216 exempt organizations filed a return on Form 1120

POL. During fiscal year 1984, we examined 124 such returns, which is approximately 57% of the total number of Forms 1120 POL filed by exempt organizations during 1984. Our agents are instructed to determine if a Form 1120 POL is required to be filed as a routine part of every examination of an exempt organization.

Senator ABDNOR: Is IRS experiencing difficulties in administering the activities of PACs? If so, what can be done to deal with the difficulties?

Mr. EGGER: In the exempt organizations area, we are not experiencing significant difficulties in reviewing PAC activities as reported on Form 1120 POL. To illustrate, for fiscal year 1984, the Service had a 24% no change rate in examining Form 1120 POL returns of exempt organizations as compared to an 18% no-change rate in examining all types of exempt organizations returns. The average tax dollar and penalty yield per examination of a Form 1120 POL return of an exempt organization is $194 as compared to $1,612 per examination of all types of exempt organization returns.

Senator ABDNOR: Although IRS has a great deal of latitude in determining what kinds of organizations are entitled to tax exemption, except for enforcement sanctions applicable to private foundations, IRS has only one sanction--denial or revocation--to deal with questionable or abusive transactions of tax-exempt organizations. Does IRS believe that current enforcement sanctions are adequate to promote efficient and effective administration of tax exempt organizations? If not, what would IRS propose be done?

Mr. EGGER: In hearings in June of 1983, before the House Subcommittee on Oversight of the Ways and Means Committee, Deputy Commissioner Owens discussed the adequacy of revocation as a sanction where two kinds of exempt organizations are involved - private foundations and public charities. The Subcommittee was reviewing the chapter 42 excise tax provisions. These provisions impose an excise tax on certain kinds of transactions with private foundations. I believe that Mr. Owens put the issue into its proper context when he said:

> Far from being harsh or burdensome, we believe the private foundation tax rules are actually beneficial to the charities that are governed by those restrictions. Absent the foundation excise tax rules, the only sanction available to the Service in the case of abuse or misconduct is revocation of the foundation's tax-exempt status. As we still see in the area of public charities, that sanction can sometimes prove to be unduly harsh and difficult to administer. For example, a hospital or university that is providing a community benefit, but is being financially abused by those who control it, would lose its tax-exempt status. In such an instance, the public and charity suffer, but the wrongdoers go unpunished. Others, including the Filer Commission, have also recognized this anomalous result. By contrast, the private foundation provisions provide sanctions only against the abusers while assuring the permanent dedication of assets for charitable uses.

We think that this kind of reasoning applies to other kinds of exempt organizations beside those Mr. Owens discussed. Proposals for changes in this sanction are a matter of tax policy that should be addressed to the Treasury Department.

TAX EXPENDITURES

Senator ABDNOR: Tax expenditures are one way the Federal government pursues public policy objectives without making budget outlays. Most tax expenditures encourage certain economic activities or reduce income tax liabilities for taxpayers in special circumstances. Currently there are over 100 tax expenditures. In fiscal year 1985, tax expenditure revenue loss is estimated at $351 billion or about 47 percent of budget receipts. By 1987, they are expected to reach $439 billion or 49 percent of budget receipts. What can IRS do to provide greater return information on the use of various tax expenditure provisions?

Mr. EGGER: The Service currently makes a great deal of information available on the use of tax expenditures through the Statistics of Income (SOI) program and its various publications and data bases. The Service's major compliance measurement program, the Taxpayer Compliance Measurement Program (TCMP), and tabulations of Master File data could also provide some tax expenditure data. SOI provides data on what taxpaying entities report on their returns whereas TCMP provides data on both taxpayer reporting and on what should have been reported as determined by a detailed audit. Due to the disclosure provisions of the Internal Revenue Code data on individual taxpaying entities are not generally publicly available. The data that are available to the public are on an aggregated basis to avoid possible disclosure of individual taxpaying entities.

In addition to the programs just mentioned, the Service is continually carrying out special studies on various subjects including tax expenditures. These studies are done at the request of organizations such as the Office of Tax Analysis and the Joint Committee on Taxation. Special tabulations are also provided to requestors outside the Federal government, usually on a reimbursable basis.

Senator ABDNOR: Is it possible for IRS to increase its use of SOI, IMF, BMF and other programs to provide detailed information on the tax expenditure provisions, such as how they are used, by whom, and the amounts involved?

Mr. EGGER: As mentioned previously, the Service already provides detailed information on specific tax expenditures through the SOI and TCMP programs, and through various tabulations of Individual and Business Master File data.

Increased use of these programs will depend on availability of resources. SOI already provides various users, on a reimbursable basis, with detailed data on specific tax expenditures. Aggregate TCMP data is now being made available to academia and other private sector research organizations to be used in a number of ways, some of which may include the study of the use of various tax expenditure provisions. These data are released under conditions set forth in the disclosure provisions of the Internal Revenue Code.

Senator ABDNOR: Could IRS use its various compliance programs to report on problems associated with specific tax expenditures?

Mr. EGGER: IRS uses its major compliance measurement program, the Taxpayer Compliance Measurement Program (TCMP), to measure taxpayer compliance with all dimensions of tax filing responsibility, and as a by-product, it focuses on problems associated with specific tax expenditures. The program covers several major types of returns filed by taxpaying entities including individuals, corporations, and partnerships. By comparing, on a line by line basis, taxpayer reported data with what a tax audit determines should have been reported, TCMP provides data on specific problem areas.

TCMP identifies problem areas but does not provide information on underlying causes. Noncompliance or abuse of tax expenditure provisions may be the result of inadequate instructions, misunderstanding on the part of the taxpayer, or the willful underreporting of income or overstatement of deductions.

Senator ABDNOR: The Treasury Department recently announced the results of its study to simplify the Tax Code. One of the major recommendations of the study was the elimination of many of the tax expenditure items included in the Code. Has IRS estimated how much would be saved in administering the tax laws if Treasury's recommendations were adopted? If IRS has made such an estimate, what would be the impact on IRS staff research?

MR. EGGER: The Treasury Department is now reviewing its earlier proposals for tax reform. While it is very difficult to know the actual impact of any tax reform proposal until the actual statute is drafted (as distinguished from the conceptual approach of the original Treasury proposal), a quick IRS impact assessment of the Treasury proposal indicated that less than 1,200 average positions per year might be made available for other necessary tax administration tasks during the first three full years of the tax reform proposal. The Service did not estimate any impact on IRS staff research. Finally, if a "return free" tax system were to be adopted, there would be an additional resource impact.

SENATOR ABDNOR: In IRS' opinion, would elimination of tax expenditures provisions have a beneficial effect on taxpayer compliance with the tax laws?

MR. EGGER: Most decidedly, yes. Taxpayers understand that income taxes are necessary to finance government activities. But their willingness to voluntarily pay these taxes depends on the belief that taxes are fair. A perception that the tax provisions are not fair could be as important as actual inequities. Taxpayers resent paying substantially more tax than "others" having the same or higher income -- even if the others reduce taxes by the use of perfectly legitimate exclusions, deductions, adjustments and credits.

TAX GAP

Senator ABDNOR: In July 1983, IRS issued a report Income Compliance Research--Estimates for 1973-1981 which estimated that in 1981 sole proprietors, partnerships, and small business corporations underreported their combined income by about $68 billion. Considering the large amount of unreported income from these types of businesses:

What special compliance programs does IRS have ongoing or planned to detect underreporting by businesses?

Mr. EGGER: In FY 1985 the IRS undertook the Nonfarm Business Tax Gap Initiative in Examination, targeting unreported income issues. Staffing provided for examinations in the high dollar business class was increased to provide the additional time to more fully explore these issues. Data is being gathered on these examinations and will be studied to seek improvements in our selection system and in examination procedures for identifying unreported income.

In our regular examination program we have continued to emphasize examining the more complex returns which reflect more abusive and evasive noncompliance patterns. Almost 28 percent of our examinations were of the complex type in FY 1984 compared to only 20 percent in FY 1981. Complex returns are primarily large dollar business returns.

We have undertaken a number of efforts to improve our programs in future years. A method to identify taxpayers involved in nonfarm business skimming operations is being explored. In the Information Returns Program (IRP), we are developing a cross reference system to link Individual and Business Master File data. This will allow business income on IRP documents (credited to an Employer Identification Number - EIN) to be credited to the taxpayer. The Payer Master File will help identify delinquent filers of information documents, many of which make qualifying payments to small business entities which go unreported. One other effort is the Tax Haven Offshore Bank Project which is attempting to identify individuals and businesses using tax havens to hide their income. This coupled with recent legislation requiring the reporting of large cash transactions, should make significant inroads into this area of noncompliance.

Senator ABDNOR: During last year's appropriations hearings, IRS requested 490 average positions and $8.8 million to undertake an initiative to contain the tax gap of more than $80 billion. IRS hoped to focus compliance efforts in areas of underreporting and tax avoidance. Included in this initiative were such efforts as doing more in-depth examinations for nonfarm individual businesses (a major area of unreported income); slowing

the growth of appeals and tax litigation inventories; keeping pace with increased collection workload and new bankruptcy filings; and increasing the collection of unpaid tax accounts.

Can IRS provide some idea of the results of its efforts in containing the tax gap? Is IRS making any progress in narrowing the tax gap?

Mr. EGGER: Our tax gap and voluntary compliance projections anticipate that recent legislation and enforcement efforts will help slow the growth of the tax gap and even reduce it slightly in the short run. In the long run; however, its growth will continue because of the growth in the tax base, e.g., growth in the workforce, as shown below:

Fiscal Year	Projected Tax Gap (Billions)*
1980	$ 62
1982	82
1984	79
1986	92

* Not adjusted for inflation

The increasing tax gap is a function of both the growth in the tax base and the decrease in voluntary compliance. Only by increasing compliance can we hope to narrow the tax gap. A one percent decrease in voluntary compliance results in billions of dollars in lost revenue. Through a vigorous enforcement program, publicity and education, the Service hopes to minimize or reverse the decrease in compliance and thus control the tax gap.

Our enforcement efforts to contain the tax gap continue to produce significant amounts of revenue. Enforcement revenue will increase from almost $26 billion in FY 1982 to a projected $34 billion in FY 1986, a 32 percent rise.

Senator ABDNOR: To what extent is IRS proposing continuing or expanding these efforts in this year's appropriations request?

Mr. EGGER: IRS is continuing these efforts in FY 1986 to contain the tax gap. We will match all usable wage and information returns, about one billion documents, including mortgage payments for the first time, against individual tax returns. We will examine almost 1.4 million tax returns and will follow-through on the registration of tax shelters and reporting of cash transactions of $10,000 or more, two important legislative provisions to improve compliance. We will close almost 3.3 million taxpayer delinquent returns. Over 6,000 investigations of possible tax fraud will be initiated. Overall, we anticipate collecting $34 billion in revenue from direct enforcement, about $400 million more than FY 1985.

TAXPAYER SERVICE ACTIVITIES

SENATOR ABDNOR: According to IRS budget data, from July 1978 through September 1983, IRS' taxpayer service program activities were funded separately from IRS' enforcement functions. Funds for those activities were included under the returns processing func-

tion. The budget data for fiscal year 1984 shows, however, that funding for taxpayer service activities was included with the investigation and collections enforcement functions. The budget data for fiscal year 1985 shows that taxpayer service funds were included with the collections function. What is the rationale for providing taxpayer service funding as part of an enforcement appropriation instead of the returns processing appropriation?

MR. EGGER: Our initial reason for placing Taxpayer Service in the same appropriation as Collection reflected the proposal, made at that time (FY 1984), to limit assistance to tax account questions. Because of the close connection between Collection and Taxpayer Service on handling tax accounts, placing both activities in the same appropriation made sense. Subsequently, the Congress restored sufficient funds to maintain the full range of assistance to taxpayers -- education, filing, tax account data. Even with the restoration of resources and programs, the placement of Taxpayer Service with Collection in the same appropriation continues to make good sense. Taxpayer assistance is provided at district offices; returns are processed at our ten service centers -- separate cost centers. Moreover, at our smaller district offices, efficiencies have been achieved by eliminating overhead and streamlining managerial support. District Directors have the resource flexibility to augment service to taxpayers by detailing enforcement personnel at peak times. Finally, ADP modernization, particularly the automated collection system, has provided greater opportunities to assist taxpayers in resolving account questions and problems.

Senator ABDNOR: Was the change motivated by a desire to use taxpayer service personnel to help offset a reduction of nearly 1,000 collection staff year positions as indicated by budget data for fiscal years 1983 through 1985? If so, was any consideration given to the impact on taxpayer service, including the possibility that taxpayers might question the credibility of assistance provided by personnel also involved in enforcement activities?

Mr. EGGER: The change was not motivated by a desire to use Taxpayer Service personnel to offset staff reductions in Collection. On the contrary, we have redirected resources to Taxpayer Service from enforcement when workload required such action.

For many years, we have used enforcement personnel, on detail, to augment Taxpayer Service, particularly at peak days, such as Mondays, and at peak times during the day. These employees have received special training and have provided courteous and thoughtful assistance to taxpayers. As IRS employees, they recognize the need to advise the public of their rights and responsibilities.

Senator ABDNOR: IRS' fiscal year 1985 budget proposals provided for an increase of 211 permanent taxpayer service positions and for detailing an additional 84 staff years from other IRS units to taxpayer service during the tax filing season on a temporary basis. However, at the same time, the budget proposals provided for a decrease in temporary taxpayer service positions of 353 staff years.

What motivated IRS to decrease temporary taxpayer service positions while at the same time increasing permanent positions?

Mr. EGGER: The taxpayer service program has effectively managed its staffing by maintaining a level of permanent staff sufficient to meet the needs of the lowest volume period of the year (that is, May through December). Taxpayer service has experienced an increase in the proportion of workload that falls in that period. This shift in the workload distribution through the year has necessitated an increase in the number of permanent employees. As the workload volume increases in the January through April time period, staffing is augmented with temporary employees and the additional details in from other IRS functions.

Senator ABDNOR: Did this change result in a reduction in the number of assistors available during the filing season when taxpayer service activities are most in demand?

Mr. EGGER: The FY 1985 budget proposal anticipates an increase in productivity which will allow a decrease in the number of average positions needed to assist about the same number of taxpayers in 1985 as were assisted in 1984.

Senator ABDNOR: Was this change motivated to any extent by the desire to have more full-time taxpayer service personnel available throughout the year to assist in other activities, such as collection activities?

Mr. EGGER: The change in staffing mix was necessitated by the need to serve the larger number of taxpayers asking for assistance in the May through December period. In those instances where taxpayer service personnel are needed to perform other activities, such as collection work, an inter-appropriation transfer of funds is made from the benefiting activity to taxpayer service. This ensures that taxpayer service resources are not diverted from their intended use--service to the public.

Senator ABDNOR: The fiscal year 1985 budget proposals provided for IRS to assist about 400,000 more taxpayers in fiscal year 1985 then in fiscal year 1984. Although IRS expected to assist 400,000 fewer taxpayers using its traditional walk-in, correspondence, and toll-free telephone assistance programs, it expected to assist 800,000 more taxpayers through its Tele-Tax and Tax-Dial systems -- a net increase of 400,000 taxpayers.

Was IRS successful in diverting taxpayers from its traditional programs to Tax-Dial and Tele-Tax?

Mr. EGGER: Tele-Tax was developed as a supplement to the various means by which we make tax information available to the public. While we feel that those taxpayers who receive a full or partial answer from Tele-Tax would be less likely to contact IRS for assistance, we are unable to determine to what extent those taxpayers have no subsequent need to also call the toll-free number.

Senator ABDNOR: Has the percentage of taxpayers satisfied with assistance Tax-Dial and Tele-Tax provides increased from the 37 percent reported by IRS when it initially tested the programs?

Mr. EGGER: During 1984, we received over 3.4 million calls on the Tele-Tax system. This was an increase of 88.9% compared to 1983, and we expect continued growth in 1985. During 1984, our surveys showed that 37.4% of all callers received a complete answer to their question. In addition, 46.9% of all callers indicated they had received a partial answer to their question.

Senator ABDNOR: What controls does IRS have to insure that the Outreach Program did not duplicate volunteer activities?

Mr. EGGER: Internal Revenue Manual 6570, Taxpayer Education Handbook, provides guidelines for establishing Community Outreach Tax Assistance sites. Outreach is directed primarily to low and middle income groups. Our volunteer programs, VITA (Volunteer Income Tax Assistance) and TCE (Tax Counseling for the Elderly), are directed to low income, elderly, handicapped and non-English speaking taxpayers. It is recommended that Outreach sites be established in areas where individuals or groups are unable to seek or have difficulty seeking taxpayer assistance during regular IRS business hours, areas where taxpayers were previously served by the IRS but where offices are now closed, and areas not served by the VITA and TCE programs. Fiscal year objectives for FY 1985 call for increases in the combined VITA, TCE, and Outreach programs and, at the same time, call for increases in VITA and Outreach separately over prior year levels. This will ensure increased activity in each program independently.

Senator ABDNOR: According to IRS reports, between fiscal years 1981 and 1983 the number of walk-in offices had been reduced by 43 percent, from 829 to 472. As an alternative to walk-in assistance, the fiscal year 1984 IRS budget expanded the Outreach Program and the 1985 budget proposals provided for continuing the program at fiscal year 1984 levels.

Has IRS made any studies comparing the costs of providing return preparation assistance through the Outreach Program to the costs that would be incurred to provide similar assistance at its walk-in offices?

Mr. EGGER: The Service has made no studies comparing the cost of Outreach assistance with the cost of providing assistance in walk-in offices. Both our walk-in offices and Outreach sites provide group self-help return preparation assistance. Outreach also offers tax information seminars, where individuals and groups assemble to hear IRS representatives discuss tax law changes, specific areas of tax law, and other tax information of special interest to them. In 1984, our experience indicates the public prefers the information seminars. As a result, Community Outreach Tax Assistance is offered to the public year-round to promote voluntary compliance, provide tax help, and increase the IRS presence around the country in a most positive way.

Senator ABDNOR: To what extent does the Outreach Program duplicate the tax return preparation assistance provided by volunteers?

Mr. EGGER: VITA and TCE provide both self-help and direct tax return assistance to taxpayers. The only duplication is in the self-help assistance offered. Outreach assistance does not include direct tax return preparation. Outreach, however, provides tax information seminars in addition to group self-help sessions. Outreach provides tax information seminars to individuals, business, or farm income taxpayers. This includes self-employed persons with or without employees. VITA and TCE assist only individual income tax filers. In contrast to VITA and TCE, Outreach activity is offered year-round.

PROBLEM RESOLUTION PROGRAM

Senator ABDNOR: In its September 1979 report on how taxpayer satisfaction with IRS' handling of problem inquiries could be increased (GAO/GGD-79-74), GAO pointed out that taxpayers who were unsuccessful in having their problems resolved through normal IRS channels were not being referred to the Problem Resolution Office soon enough. In March 1981, IRS, in response to a GAO recommendation, revised its questionnaire used to follow up with taxpayers served under the Problem Resolution Program. The revised questionnaire includes a question about the number of contacts taxpayers have had with IRS about their problems before being referred to the Problem Resolution Program. Have responses to the questionnaires, to date, shown an improvement in the timeliness with which taxpayers who have persistent problems are being referred to the Problem Resolution Program as compared to the conditions at the time of GAO's review?

Mr. EGGER: We do not track through a management information system specific information from the follow up questionnaires regarding the number of prior contacts. Rather, this information is reviewed at the local level on a case by case basis to determine if there are problems with complaints not being referred to the Problem Resolution Program (PRP) when they first meet the criteria. However, our receipts have grown dramatically since 1979 and the vast majority of cases continue to come from internal employee referrals rather than requests for PRP by taxpayers. In FY 1979, PRP received 79,234 cases; by FY 1984, receipts had increased to 385,856.

TAXPAYER CORRESPONDENCE

Senator ABDNOR: In the same report, GAO pointed out that the primary cause of taxpayers dissatisfaction with IRS was problems with the communications they received. As late as November 1984, in a Commissioner's Advisory Group meeting, lengthy discussions focused on the nebulous content and negative tone of IRS correspondence to

taxpayers. Why has IRS taken so long to overcome the problems cited in GAO's September 1979 report?

Mr. EGGER: The IRS has taken several steps to clarify our correspondence to taxpayers. This includes establishing a Notice Clarity Task Force to review all notices sent to taxpayers. There has also been an executive level study group which reviewed both the procedures for responding to taxpayers and the content of the letters we are sending. As a result of these efforts our correspondence has been revised to be clearer and more responsive to taxpayers. For example, over 396 service center letters alone have been revised. Because of the complexity of the law, it is difficult to make explanations of changes simple and precise. However, the problems identified by GAO have beem addressed and improvements have been made.

Senator ABDNOR: What are the IRS' target dates for improving the content and tone of its communications with taxpayers?

Mr. EGGER: The IRS has already taken steps to improve correspondence as discussed above. There is an ongoing review of correspondence in order to make it clearer and more responsive to taxpayers.

DELIVERY OF FORMS AND PUBLICATIONS

Senator ABDNOR: According to newspaper reports, IRS uses the United Parcel Service rather than the United States Postal Service to deliver at least some of the forms and publications ordered by taxpayers.

To what extent is the United Parcel Service used by IRS to deliver forms, publications, and other items to taxpayers?

Mr. EGGER: In its FY 1984 order fulfillment program, IRS paid the United Parcel Service (UPS) $4,700,000 and the United States Postal Service (USPS) $9,330,757. UPS is used when the service they provide, within set cost parameters, surpasses that provided by the USPS. Consideration is given to the weight of the packages, the required delivery time and the sensitivity of the contents.

The decision to use UPS versus USPS was decentralized to our field offices in October of 1983. The rationale for this decision lies in the fact that neither USPS nor UPS service was consistent on a nationwide basis. Service levels vary from region to region, e.g., the delivery of a one pound package within a 200 mile radius of the distribution center may take 4 days via USPS from Kansas City, MO, and 7 days from Atlanta, GA.

Each year, the regional offices review their prior year results, the current rates for both UPS and USPS and any proposed changes with either system. Based on this review, each regional

traffic manager establishes a mail plan delineated by weight break. These mailing plans are reviewed in the National Office.

Senator ABDNOR: Were cost studies made to justify the use of the United Parcel Service, and if so what were the results?

Mr. EGGER: The National Office conducts a national cost comparison study of USPS rates versus UPS rates. This study is completely redone each time there is a change in the rates, zones or shipping requirements of either system.

These studies show that overall 1st class mail is the least expensive mode up to 4 ozs., Special 4th class is cheaper up to 5 1/2 lbs., then UPS up to 17 lbs. Unfortunately, we cannot always use Special 4th class.

These cost comparisons are used to analyze the annual mail plans submitted by the regional offices. Since, service requirements are also a consideration when determining which service to use, each region also conducts a transit time study to analyze the service levels of the various classes of mail used and UPS. There are cases where UPS costs are slightly higher than USPS. In our North Atlantic Region our service levels for 4th class mail were so poor, we use UPS for all material over 4 ozs. In this case, UPS provides us with next day and second day delivery within most of the region. To obtain similar service from USPS would require the use of 1st class or priority mail at a much higher cost.

TAX RESEARCH

Senator ABDNOR: IRS continually strives to improve the process of selecting the tax returns with the greatest audit potential. During last year's appropriations hearings, IRS said it was going to undertake about four or five research projects, including one with the American Bar Association.

Please provide a summary of the results of IRS research efforts during the past 3 years. Is there any indication that those research projects operationally reduce noncompliance?

Mr. EGGER: We strongly believe that our research program has had a major impact on the Service's ability to address noncompliance. First, based on such recent experience as TEFRA, research to identify noncompliance and develop legislative solutions alone can increase receipts by billions of dollars by the resultant improvement in voluntary compliance. Second, it is estimated that research that resulted in improvements to individual and corporate tax return selection techniques will produce an additional $180 million per year. Third, we have a continuing research effort underway to develop non-labor intensive, low-cost computerized alternatives to conventional methods of

increasing compliance and closing the tax gap. This effort has resulted in millions of dollars in additional revenue.

Senator ABDNOR: Are the research efforts normally done by IRS or outside contractors? Does contracting out cause IRS any particular problems, such as tax data disclosure or security problems?

Mr. EGGER: The majority of our research activities are conducted in-house. However, the Service does use its Research and Development (R&D) Fund (i.e., $4.1 million) to procure private sector research and management analysis services. In general, the R&D Fund is used to finance important research where IRS staff expertise in a technical research area is lacking or data processing resources are not available.

Pertinent Disclosure and Security Safeguards (i.e., Internal Revenue Code Sections 7213 and 7431, Privacy Act of 1974, and United States Code Section 552a) are adhered to in all contracts potentially involving tax return data. Essentially, these provisions make contractors subject to the same sanctions as Service employees.

Senator ABDNOR: What level of research is proposed for fiscal year 1986?

Mr. EGGER: The FY 1986 research budget will be funded slightly below the FY 1985 level. Contained in the base will be resources for the continuation of the research initiative at 102 staff years or 20 percent below the FY 1985 level. This initiative was developed to ensure that an investment in research is made without further diversion from field enforcement operations. The resources will be used to conduct research designed to improve operational productivity; to develop models to allocate resources more effectively; to develop new techniques to streamline our enforcement processes; to analyze the specific nature of particular tax gap components; to identify and probe new and potential areas of noncompliance; and to identify factors affecting compliance.

A Research and Development (R&D) Fund of $4.1 million (a rollover from FY 1985) for conducting research is contained in the FY 1986 budget request. For FY 1986, we are requesting that $500,000 of this fund be designated as "no-year" funds, which represents a fifty percent reduction in the FY 1985 "no-year" fund authority.

The R&D Fund will be used to finance important research where IRS staff or ADP support cannot be furnished due to a lack of expertise in a technical research area or unavailability of resources, respectively. Projects typically funded through R&D include: 1) use of commercial lists and other public

data to identify low-cost computerized enforcement alternatives, 2) measurement of cash flows to tax haven countries, 3) unreported income research, such as informal suppliers study, 4) tax forms and instruction simplification, 5) opinion surveys, 6) National Academy of Science Panels, and 7) state-of-the-art research exploring the uses of artificial intelligence/expert systems as applied to various tax administration areas.

Senator ABDNOR: What demand do research projects place on IRS' resources? Are existing resources generally sufficient to deal with the problems uncovered by research projects?

Mr. EGGER: With the majority of our research projects requiring front-line data gathering by field enforcement personnel, our rationale for continuing the research initiative is to ensure that an investment in research is made without further disrupting field enforcement operations. It should be mentioned that some of these research activities will have a positive cash flow, as well as significant "presence" or deterrent effect, while simultaneously providing invaluable information on known or suspected compliance problems.

Generally, if resources are not sufficient to quickly deal with problems uncovered by research projects, the Service has normally requested the necessary resources.

Senator ABDNOR: Last year, IRS also said it planned technological initiatives in service center conferencing, portable and intelligent computer terminals, computer graphics, and voice recognition.

What is the status of these projects? Does IRS plan to continue these efforts or will new technologies be pursued?

Mr. EGGER: Each of these technologies will be continually followed by IRS. Service Center conferencing and voice recognition do not appear to hold immediate benefits to us. Portable computers appear to have immediate benefits and we will continue to follow this technology. Computer graphics is being pursued in some areas but to a lessor extent. These projects have been augmented by the following new technological initiatives: 1) use of fourth generation languages as an alternative to COBOL in tax processing; 2) use of Laser Disks for mass storage of data; and, 3) Expert Systems (Artificial Intelligence).

Senator ABDNOR: How do these projects benefit IRS and/or the tax process?

Mr. EGGER: The benefits of these initiatives are: 1) use of a fourth generation language has a significant potential for increasing programming productivity as well as reducing end user dependence on programmers; 2) introduction of Laser Disk technology will provide us with the capability of high-speed retrieval of mass storage combined with compact size and cost effective operation; and, 3) use of Expert Systems (Artificial Intelligence) will enhance the decision making.

TAX REFUND OFFSET PROGRAM

Senator ABDNOR: IRS participates in a program with state returns processing agencies to collect child support due known as the Tax Refund Offset Program. Recently, with the passage of the Tax Reform Act of 1984, the program has been expanded to require IRS to withhold a tax refund to the extent that a past-due legally enforceable debt is owed a federal agency.

Does IRS have any indication whether the Tax Refund Offset Program is adversely affecting compliance?

Mr. EGGER: In a report "The Effect of Refund Offsets for Delinquent Child Support Payments" dated February 1984, several adverse tax consequences were revealed:

- Taxpayers subject to a refund offset in tax year (TY) 1981 were twice as likely not to file a return for TY 1982. Twenty-six percent of taxpayers who were offset in TY 1981 did not file a return for TY 1982.

- Taxpayers who were offset against in TY 1981 and who subsequently filed a TY 1982 return were three times as likely to become delinquent in paying their TY 1982 tax as compared to a control group of taxpayers without an offset.

- There was a noticable decrease in the size of the refund available for offset for the study group from TY 1981 to TY 1982, as compared to the control group. The decline in refund size might be related to decrease in the number of dependents claimed on the tax returns.

- Two-thirds of the TY 1981 refund offset cases were also identified for a potential offset in TY 1982, indicating that the offset program had not greatly affected the pattern of nonpayment.

Senator Abdnor: How much of IRS' resources are devoted to performing services which are essentially not tax functions?

Mr. Egger: During Fiscal Year 1985, the Service will expend an estimated 39 staff years on non-tax functions for the Child Support Refund Offset Program. The 39 staff years are reimbursed to the Service from the participating state agencies. In 1985, the Service has absorbed the developmental and systems design costs to bring federal agencies on board in 1986. An undetermined additional amount of staff years will be expended in 1986 when the federal agency offsets are implemented. The Service will be reimbursed by those participating federal agencies.

Senator Abdnor: Are the number of offsets and recovered dollars diminishing? Please furnish summary data on the number and dollar offsets expected to be realized for child support and satisfying federal debts.

Mr. Egger: The total number of returns offset and dollar amount collected have increased since the beginning of the program in 1982. For 1982, we had a total of 279,000 offsets and a total collection of $174 million. For 1983, we had a total of 340,000 offsets and a total collection of $179 million. For 1984, we had a total 423,000 offsets and a total collection of $211 million.

One million cases have been matched to the Individual Master File for offset for 1985. We cannot determine at this time what the total dollar amount of offsets will be for this year, however, it is projected to exceed last year's total amount of $211 million. So far this year, there have been 104,000 offsets and a total collection of $50 million.

An estimated 2.4 million accounts totalling $7 billion is projected from other federal agencies anticipated to be added to the program. At this point, we cannot determine the number of hits the agencies will have. However, the Service has conducted a test, and the result indicated that 85% of the accounts submitted would result in an offset.

Senator Abdnor: Can IRS provide some idea of the cost per offset of this service?

Mr. Egger: The cost per offset for child support refund offset cases is $3.20. The cost per offset for federal agency debts is projected to be substantially the same.

Senator ABDNOR: Once people subject to an offset find that IRS will not give them their tax refunds, do they adjust their withholding amount to eliminate their refunds?

Mr. EGGER: In the same report cited above, an evaluation of the change of withholdings as a ratio of salaries from TY 1981 to TY 1982 did not reveal a significant difference between those individuals with a refund offset for child support and a control group of

taxpayers without an offset. It must be noted, however, that there had been insufficient time for taxpayers to react by changing their yearly withholding so as to have this change detected by the study methods employed. A follow-up study to be completed shortly will provide more conclusive results.

TIP INCOME COMPLIANCE EFFORTS

Senator ABDNOR: Although voluntary compliance is the cornerstone of our nation's tax system, more and more individuals are ignoring the tax laws by either not reporting or underreporting their taxable income. In an effort to revise this situation, the Congress passed TEFRA, which contained several provisions for improving tax compliance. One such provision for improving compliance dealt with placing additional reporting requirements on the food and beverage industry for the purpose of capturing underreported tip income. These additional reporting requirements have been labeled as unfair and costly by the industry.

How much in additional revenues have been collected that can be directly related to the new tip reporting requirements?

Mr. EGGER: For establishments in business both in 1982 and 1983, tips reported to employers by employees increased by $1.06 billion or 108 percent of the 1982 reporting level.

Senator ABDNOR: How effective have TEFRA'S tip provisions been in curbing noncompliance?

Mr. EGGER: Prior to TEFRA, we estimated tip income reporting compliance to be approximately 16 percent. Based on the fact that more tip income is being reported to employers, we expect an increase in reporting of tip income on Forms 1040.

Senator ABDNOR: What is the status of the tip study that is mandated by TEFRA?

Mr. EGGER: TEFRA mandated that a study of tip reporting compliance be submitted to the tax writing committees before January 1, 1987. Since low filing compliance of tax year 1983 employer tip information returns would have led to unreliable or inaccurate study results, a one year delay (to January 1, 1988) was requested so the study could be conducted on tax year 1984 returns.

Senator ABDNOR: What has been the cost to IRS for identifying and collecting these additional revenues?

Mr. EGGER: So far, the cost of identifying and collecting additional revenues associated with the new tip reporting requirements

has been small, about $30,000 for printing, distributing, and processing forms. The legislation required a study of the impact of these new requirements based on tax year 1983 data. Unfortunately, too few returns were filed in 1983, so the study has been postponed until we receive enough 1984 returns.

Senator ABDNOR: When TEFRA was passed, IRS requested and received additional resources to implement TEFRA's provisions. What portion of these resources have been devoted to implementing TEFRA's tip provisions?

Mr. EGGER: We received one position and $151,000, including printing costs, to implement the study on the new tip income reporting. This study has been deferred due to the low volume of tax year 1983 filings of Form 8027. Only $30,000 has been spent for printing, distributing, and processing the 40,000 forms actually received.

Senator ABDNOR: What difficulty, if any, is the food and beverage industry (employers and employees) having in complying with the additional tip reporting requirements and IRS regulations?

Mr. EGGER: While the majority of employers have filed a timely Form 8027 (Employer's Annual Information Return of Tip Income and Allocated Tips) reporting the necessary information, a substantial number have failed to file. A portion of these nonfiling employers may not have filed because of difficulty in understanding the new reporting rules or in computing a tip allocation.

Senator ABDNOR: To what extent are food and beverage establishments requesting the exemption from the 8 percent minimum tip reporting requirement? How many requests for a reduction have IRS received? How many requests have been approved?

Mr. EGGER: The IRS has received 1,862 requests for a reduction and has approved approximately 630.

Senator ABDNOR: What efforts does IRS have underway at the national, regional, or district level for the purpose of increasing taxpayer compliance for all tip income, including cab drivers, barbers, cosmetologists, and food and beverage employees?

Mr. EGGER: We supplement our computerized detection methods, and our classification procedures for identifying potential unreported income cases, with Information Gathering Projects.

We currently have under way about 660 district-initiated projects, of which more than 500 deal primarily with unreported income. In addition, we have 19 regional unreported income projects.

These projects have addressed tip income of beauticians, taxi drivers, casino dealers, topless dancers, and more.

By far, our tip income projects have comprised the majority of our unreported income projects, and primarily relate to the food and beverage industry.

In addition, all income tax examiners are required to probe for unreported income during their examinations. Thus, when conducting return examinations of taxpayers in occupations where "tipping" is customary, we as a matter of course probe for unreported income.

Senator ABDNOR: How reliable is your 16 percent compliance rate estimate for tip income employees? Briefly explain the methodology used to arrive at the 16 percent compliance rate.

Mr. EGGER: The estimate is fairly accurate. It is based on a comparison of the total amount of tip income estimated by the Commerce Department and the total amount reported by tipped employees to their employers, as tabulated from Forms W-2. Only 14 percent was so reported. We found that a small additional amount of tips was reported by employees on their 1040's, even though they had not reported it to their employers. Also, we estimated that a small percentage of tip income is received by individuals who do not file required tax returns. When these additional amounts are accounted for, the overall estimate of 16.5 percent compliance emerges. These calculations were based on 1977 data; there is no reason to suppose that the compliance rate would have changed appreciably between 1977 and 1982. Since 1982, IRS has completed some research on consumer expenditures which generally confirms the Commerce Department estimates of total tips.

Senator ABDNOR: To what extent are individuals able to show that their tip income is less than the assumed minimum 8 percent rate that establishments must report?

Mr. EGGER: Congress has mandated the IRS to study the operation of this new reporting system. The study will commence during October 1985 and a report will be submitted to Congress by October 1987. The requested information is included in the study and will be contained in the report.

WAGERING TAXES

Senator ABDNOR: The Miscellaneous Revenue Act of 1951 created two types of taxes on wagering: (1) an annual tax on businesses and individuals accepting certain types of wagers, and (2) a tax on the gross wagering revenue. The tax rates for both types of taxes vary depending on whether wagering activities are authorized?

What is an acceptable level of compliance for both types of wagering taxes? What efforts does IRS have in place to insure compliance with the wagering taxes?

Mr. EGGER: The Service does not establish an "acceptable level of compliance" for any tax.

As with each tax for which the Service has compliance responsibility, resources are applied to encourage voluntary compliance.

The Service currently conducts a dual approach to ensuring compliance with the wagering taxes through the gathering of information relating to the identification of wagering tax violators, and through the identification of potential erroneous returns. These identification methods involve Service liaison with state and local law enforcement agencies through cooperative and exchange agreements. The leads received are evaluated for noncompliance potential regarding the wagering taxes and income taxes.

The Service also uses its internal data bases to identify taxpayers who may have filed one of the two types of wagering tax returns but not the other, may have used an incorrect rate of tax, or may have paid tax at a questionable level based on the amount of gross wagers.

Senator ABDNOR: Several states authorize and license wagering activities which are subject to the wagering taxes. Has IRS considered the desirability and feasibility of obtaining licensing data from these states to identify potentially noncompliant taxpayers?

Mr. EGGER: Many of our districts where wagering activities are authorized have successfully used local licensing data to identify noncompliant taxpayers. We do not have a national program in this area because of the limited number of states involved in wagering activities.

Senator ABDNOR: Since the tax rates for both types of wagering taxes vary, how does IRS insure that those taxpayers which pay at the lower rates, which apply to state authorized wagering activities, are entitled to do so?

Mr. EGGER: Each district office receives an annual listing of return information transcribed from wagering tax returns.

Wagering returns exist with separate rates for state authorized and unauthorized gambling activities as follows:

	Authorized	Unauthorized
Form 11-C	$50 per year	$500 per year
Form 730	.25% of gross wagers	2% of gross wagers

From the annual listing, the tax due or rate of tax can be determined. Each district selects for examination those taxpayers who use the incorrect rate.

Senator ABDNOR: The yearly taxes are filed on the Form 11-C. The form requires employers to list all the employees who accepted wagers on their behalf. What use is made of this information? What are IRS' procedures if the employers fail to list their employees? Since the employees are also liable for the yearly occupational tax, does IRS use the listing of employees as a means of identifying noncompliant taxpayers?

Mr. EGGER: During examinations of the wagering taxes, examiners use the information to ensure the employer has filed the required Federal Employment Tax Returns. If the employer fails to list his or her employees, we correspond for the information. If the taxpayer does not respond, we do not issue the occupational tax stamp. Criminal Investigation uses the listing of employees as basis for bringing failure to file charges where appropriate.

Senator ABDNOR: IRS requires the Form 730 for the tax on gross wagers to be filed monthly even if no taxes are owed. What is the basis for the monthly filing requirement? Would it be more cost-effective to have a quarterly filing requirement unless a specified dollar threshold is reached in which case monthly filing would be required?

Mr. EGGER: The monthly filing requirement for Form 730, Tax on Wagering, was set out in Treasury Decision 6370, dated April 4, 1959. There is no reason given for the frequency of filing. On the surface, it would appear to be more cost efficient to require quarterly filing. The net savings would amount to $21,000 or 1.1 staff years (assuming 2 monthly deposits and quarterly filing). We will look into this further.

BUSINESS ENERGY INVESTMENT CREDIT

SENATOR ABNOR: The business energy investment credit which was created to provide an incentive to invest in property that either uses or produces alternative energy sources and to overcome barriers to investing in new energy technology is due to expire on December 31, 1985.

Does IRS believe the credit should be allowed to expire or should it be extended?

MR. EGGER: The Treasury Department opposes extention of the business energy investment tax credit.

Congress enacted the energy credits because oil and gas price controls understated the replacement cost of energy. Because of price controls, consumers did not have the incentive to

invest in energy conservation and alternaative fuels. The absense of free-market prices created and economic rationale for energy tax incentives. However, since these incentives were enacted, crude oil prices have been decontrolled. As a result, these tax credits are no longer needed.

Furthermore, because these energy tax credits apply only to certain targeted activities, they introduce a tax differential among investments. They distort the allocation of resources, encouraging individuals and firms to undertake investments that are uneconomical at current and expected future market prices. As a result, these incentives divert workers, capital and initiative from more productive uses elsewhere in the economy and lower the net productivity of our nations's captial stock.

EXCISE TAXES - RECREATIONAL EQUIPMENT

Senator ABDNOR: In the closing days of the 98th Congress P.L. 98-473 at 98 STAT 1963 Sec. 315(j) was passed containing a provision which provided that

> "None of the funds appropriated by this Act or any other Act shall be used to impose or assess any tax due under subchapter D of chapter 31 of the Internal Revenue Code of 1954, as amended, section 4161 and 4181, in all cases where less than fifty items are manufactured or produced per annum."

What action has the service initiated to ensure that the various excise tax field offices are aware of this new provision?

Would you please provide copies of any notices prepared by the Internal Revenue Service to the excise tax field offices relative to this new provision.

Mr. EGGER: We haven't sent out a specific notice to that effect, Senator, but it does seem prudent to do so. We will issue a notice and provide you with a copy of the notice for the record.

Internal Revenue Service
memorandum

VIA FACSIMILE

APR 11 1985

All Assistant Regional Commissioners (Examination)
(Information Copy to All Regional Commissioners)

Assistant Commissioner (Examination) OP:EX

Excise Taxes - Recreational Equipment

Public Law 98-473, dated October 12, 1984, at 98 STAT Sec. 315(j) placed into effect the following provision: "None of the funds appropriated by this Act or any other Act shall be used to impose or assess any tax due under subchapter D of chapter 32 of the Internal Revenue Code of 1954, as amended, sections 4161 and 4181, in all cases where less than fifty items are manufactured or produced per annum."

These provisions are not revisions to the Internal Revenue Code but merely restrictions on how we may spend our appropriated funds for FY 1985. Therefore, all FY 1985 Examination actions directly related to imposing or assessing excise taxes under IRC Sections 4161 and 4181 will cease at once where less than fifty items are manufactured (or imported), or produced per annum by the taxpayer.

The excise taxes affected by P.L. 98-473 appear on Form 720, Quarterly Federal Excise Tax Return, IRS Numbers 32, 41, 42, 44, 46, and 49. If you have any questions, please have a member of your staff contact Ron Linden of my staff at (FTS) 566-6472.

QUESTIONS SUBMITTED BY SENATOR WILLIAM PROXMIRE

EXECUTIVE DIRECTION

Senator PROXMIRE: Within the Salaries and Expense Account funding for Executive Direction increases slightly over last year's level of $8.4 million. But funding for the Executive Direction function (includes Commissioner's office staff, etc.) has increased rather dramatically since fiscal year 1984 -- from $6,352,000 to $8,449,000 next year, or about 33%.

Why the big percentage jump in Executive Direction funding over the past few years?

Mr. EGGER: For FY 1984, Congress authorized a funding level of $8.1 million for the Executive Direction activity. In FY 1986, we are requesting $8.4 million, an increase of only 3.7 percent over a two year period.

Actions were taken in FY 1984 to limit expenditures and higher turnover in positions caused us to underspend by $2.1 million.

Our authorization for FY 1985 is $8.4 million, the same amount be requested for FY 1986.

The FY 1984 actual expenditure was below the approved level because funds were applied to areas of greater need within the Service. We fully intend to realize the entire FY 1986 requested level.

SALARIES AND EXPENSES: TRAVEL

Senator PROXMIRE: Travel under the Salaries and Expenses account is about the only subactivity that goes up next year over the fiscal 1985 level -- from $1,558,000 to $1,717,000, or better than 10%. We all know that there have been good, low fares during fiscal year 1985 and expectations are that those will continue into FY 1986 as the airlines become more and more competitive.

Why should we approve any increase over last year, especially when your staffing is dropping by 86 positions in the S&E area in FY 1986?

Mr. EGGER: Our travel budget includes not only transportation costs which have stabilized somewhat but also per diem and relocation expenses which have risen. The increase being requested, $159,000 is to realign travel charges and is balanced by corresponding reductions to other accounts. Servicewide, travel is being reduced $1.9 million. As part of our responsibilities to direct and monitor field operations, we need to travel to our regional and district offices.

GENERAL: ADMINISTRATIVE SAVINGS

Senator PROXMIRE: You indicate in your justifications that you intend to reduce administrative services costs by ten percent or $21.7 million next year -- a reduction mandated by the President's directive to hold down administrative overhead costs next year. My guess is that the President is hoping that agencies cut back on such administrative expenditures as travel; consultants; public affairs; xeroxing; and other true administrative costs. Your cut seems to be mostly in people, with reductions of 566 positions in administrative staff and 350 slots in so-called overhead and program support efforts.

Yet your traditional administrative costs, such as travel and so forth, either dip only slightly or actually increase.

Aren't you really going after people rather than administrative expenditures. With IRS enjoying such a high return per dollar on staff, wouldn't it make more sense to cut back on wasteful expenses and put your people to work in other, more productive areas such as collections and exams?

Mr. EGGER: Yes, we are cutting staff as part of our overhead and administrative services reduction. With the labor intensive nature of the Service, any significant cost reductions must include personnel. Included in the $21.7 million is $3.3

million for substituting lower graded for higher graded employees in the GS 11 - 15 band.

Traditional administrative costs, such as supplies, internal printing and reproduction, furniture and office equipment are also being cut. Travel, on the other hand, is predominantly an operating cost -- our enforcement personnel must visit taxpayers at their places of business to audit returns, collect unpaid taxes and investigate fraud.

Any further reduction to administrative resources would be counterproductive and negatively impact the effectiveness and high dollar return of our enforcement personnel in areas such as collection and examination. These areas would not have the resources, such as operating travel to fully perform their duties and would have to direct some of their time from front line operations to perform administrative duties.

TAXPAYER SERVICE

Senator PROXMIRE: Although your taxpayer service budget remains virtually the same as last year's your justifications indicate you will actually assist more than 2 million fewer taxpayers in fiscal year 1986 than you did this year. Taxpayers assisted in fiscal 1986 are also about 4.8 million fewer than the number assisted in fiscal year 1984.

Why are you reaching fewer taxpayers who need help in fiscal year 1986? Your budget is about the same as last year and is up nearly $16 million since fiscal year 1984.

Mr. EGGER: The type of work that taxpayer service performs has been changing in character. The trend has been towards a higher percentage of calls from taxpayers concerning their accounts or concerning notices issued from our service centers. This work is more time consuming than other work and lowers overall productivity. Another aspect of the changing character of taxpayer service work is the siphoning-off of easy questions from our work by automated methods of assistance. Tele-Tax recordings and multifunctional equipment (which can answer refund inquiries and provide recorded tax information) are effective in assisting people with relatively easy questions. Those taxpayers that cannot be assisted in this manner must talk with a taxpayer service assistor. These more complex questions also tend to lower overall productivity.

I feel this is a desirable trend. We make a considerable investment in training our employees and I would much rather see them spending their time talking with taxpayers on the more complex issues. We can be more effective in managing our operation by leaving the quick and easy questions to the machines.

I would like to point out, too, that our estimates for the number of taxpayers to be assisted through Tele-Tax and multifunctional equipment are conservative. These are new programs with little or no historical trends to look to for guidance. The number of taxpayers assisted through automated responses could be substantially higher than our estimates show.

The taxpayer service budget activity suffers the same problems with escalating costs as do all other organizations. In the years from 1984 to 1986 the direct cost for a newly hired employee has risen 16%. The average for GSA space rental has increased 18%. The cost of toll-free telephone circuitry has increased 26%. These and other costs of doing business have risen 11% in this budget activity even though average positions have decreased by 225.

INVESTIGATION, COLLECTION, AND TAXPAYER SERVICE: OTHER SERVICES

Senator PROXMIRE: Your budget for so-called other services jumps by more than 14% next year — from $31,327,000 to $35,706,000. What is the reason for this increase and what components make up the increase over last year?

Mr. EGGER: The other services portion of our budget contains a variety of expense categories including enforcement expenses, maintenance of equipment, guard services, site preparation funds, and ADP contracts. The net increase of $4.4 million reflects increases in ADP contracts for the automation of the Collection function ($7.7 million) and equipment maintenance ($ .7 million) offset by a decrease in site preparation (-$4.0 million).

CONSULTANT SERVICES

Senator PROXMIRE: Your consulting and related services budget under Investigation, Collection and Taxpayer Service increases a staggering 7-fold next year -- from $173,000 in fiscal year 1985 to $1.3 million next year. Why in the world should this committee approve this type of increase for consultant services at a time when the President is calling for cutbacks in consultants and other administrative services?

Mr. EGGER: The increases are not as great as they first appear due to FY 1985 funds being withheld from obligations (P.L. 98-473 - Continuing Resolution for FY 1985). We are, however, requesting increases to obtain needed technical services from outside sources. These services are needed in our Collection Activity where they will assist in the Automated Collection System and Collection Field Force automation projects. Of the $1.3 million requested in FY 1986, only $264,000 is for consulting services; the balance is for management and professional services including special studies and analyses. The budget reflects the more comprehensive definition of consulting and related services which the Administration is now using.

FY 1987 Revenue Initiative

Senator PROXMIRE: You indicate in your budget justifications that the Service intends to embark on a major revenue initiative between 1987 and 1989 -- an initiative that has the support of the Grace Commission and which will increase revenues by $4.6 billion over three years by adding 2,500 average positions a year to the examination of tax returns.

In your justification you say that you will begin advance hiring late in fiscal year 1986 to ensure full revenue potential in fiscal year 1987.

Now, you got yourself is some trouble with this Subcommitee a few years back when you went ahead and hired several hundred new employees without any appropriation bill or Continuing Resolution in place.

Do you intend to start hiring 2,500 new personnel in fiscal year 1986 without a fiscal year 1987 appropriation bill in place to give you the money to hire those folks?

Mr. EGGER: If savings can be identified we will want to proceed with hiring agents in advance of the revenue initiative planned for FY 1987-1989. I recognize the Committee's concerns regarding advance hire and I can assure you that no hiring will be done without the Committee's approval. In fact, that is why I wanted to highlight our thoughts on this issue in my testimony. Any advance hiring will occur during the final months (June, July, August) of FY 1986. Before then we will have presented to the Committee our FY 1987 budget, containing the revenue initiative proposal. This affords the Committee another opportunity to discuss the merits of the proposal.

Senator PROXMIRE: What if Congress cut your budget for fiscal year 1987 way back and you have staffed up on the hope that Congress would come through? What then?

Mr. EGGER: We do not anticipate this problem occurring. The Committee will be reviewing our FY 1987 budget prior to the time we would initiate any advance hiring. Should the Committee decide not to approve the revenue initiative, we certainly would not initiate any advance hiring.

CONSULTANT SERVICES

Senator PROXMIRE: You are requesting nearly a 43 percent increase in consulting and related services next year for your Examination and Appeals program -- up from $281,000 this year to $491,000 next year. At a time of spending restraints, why should we cut you back to last years level or lower for consulting services in fiscal year 1986? What would be the effect on Examinations and Appeals activity next year?

Mr. EGGER: The funding for consulting and related services authorized in FY 1985 is $508,000 however, Section 515 of the General Government Appropriations Act enacted by reference in the Continuing Resolution for FY 1985 (P.L. 98-473) withholds $227,000 from obligation. We have achieved the reduction of $227,000 by deferring projects in FY 1985 -- moving them forward into FY 1986. Consultant services are needed to develop formulas for mathematically scoring tax returns and to proceed with the new automated examination system.

INTEREST PAYMENTS ON TAX REFUNDS

Senator PROXMIRE: The amount of interest IRS pays on taxpayer overpayments has increased from about $500 million in fiscal year 1980 to almost $2 billion in fiscal year 1983. TEFRA gave IRS some measure of relief by providing that no interest will be paid until a return is filed in a form suitable for processing. TEFRA also changed the means by which interest is calculated for tentative carrybacks and delinquent filers. As a result of TEFRA and declining interest rates, IRS interest payments declined to about $1.3 billion in fiscal year 1984. What are the reasons IRS attributes to interest payments remaining sizable?

Mr. EGGER: In 1980 the rate of interest was 6%. Since then, the rate has fluctuated between 11 and 20%. In fiscal year 1984 nearly 700 million dollars of interest was paid on individual and corporate tax adjustments. This represents 54% of all interest paid in fiscal year 1984. Interest paid on original returns filed (original settlements) represents 24% of the interest paid. The interest paid on Audit adjustments or amended returns may require the payment of interest for any period up to three years from the date of original filing. Lately, there is a trend for taxpayers to file closer to the return due date. This causes the Service a problem of timely processing returns within the 45 day interest free period. The volume of individual returns filed during the three to four weeks prior to the due date represents one-third of all individual returns filed.

LIMITED PARTNERSHIPS

Senator PROXMIRE: At the present time, I understand that IRS has about 350,000 tax shelter returns under examination or in suspense. In addition, there is a large number of cases being considered by appeals and over 20,000 cases pending at the Tax Court. These cases represent more than $10 billion dollars in potential tax liability. The 96,000 shelter cases which IRS closed in 1983 represented only 1 percent of the individual examinations closed, but they contained 40 percent of the total additional taxes and penalties recommended by examination in individual tax cases in 1983:

Give us 3 specific new plans IRS has prepared to deal with the shelter programs and tell us how much additional revenue your efforts will bring in next year?

Mr. EGGER: We have established Abusive Tax Shelter Detection Teams in each of our Service Centers. These teams bring together all the various sources of abusive tax shelter information. Their primary goals are to identify abusive tax shelter schemes for possible criminal and/or audit investigation, identify trends, and to assist our district offices in developing cases against the abusive tax shelter promoters.

The moment we identify an abusive tax shelter scheme, we move quickly to stop the money from going out the door. When appropriate, we "freeze" the portion of tax return refunds attributable to the scheme. When we identify the abusive schemes

before the 1040's are filed, we send taxpayers letters warning them that we'll disallow the deductions and tax credits if they claim them on their returns.

When we determine that a taxpayer is involved in a scheme where it is highly likely that the scheme is false or fraudulent or the shelter's asset has been overvalued we tell the employer to reduce the employee's withholding allowances. The result is that the correct amount of income tax withholding continues to flow into the Treasury and we do not have to spend years undoing by audit the taxpayers' schemes.

We fully recognize the sensitivity of Congress and the public about holding refund checks or reducing withholding allowances. Our procedures, which include the personal involvement of the highest level of IRS management officials, ensure that we do not interrupt the normal refund process unless supported by strong and positive evidence that a tax shelter is abusive.

AUTOMATED COLLECTION SYSTEM

Senator PROXMIRE: In addition to increased staffing, IRS mentioned at last year's appropriation hearing that automating the collection process was a primary initiative to improve collection operations and to accelerate the collection of unpaid taxes. In this regard, the automated Collection System (ACS) was to be implemented nationwide in fiscal year 1984 along with the automation of other collection activities which automated much of IRS's office collection activities.

Does IRS have any estimates of potential savings or increased collections from ACS or from automating some of the other collection activities.

Mr. EGGER: I am very proud to say that ACS was successfully implemented nationwide in FY 1984, with the final phase being completed on June 18, 1984, approximately three weeks ahead of schedule.

We are extremely pleased with the operation of ACS. In addition to an annual savings of 1700 staff years reduced in prior budgets (865 FY 84, 842 FY 85), ACS has exceeded the performance level of the Collection Office function (COf) which it replaced. Since all ACS call-sites were not operational for the full fiscal year, comparisons with the former Collection Office function are difficult. However, a comparison of the four pilot sites that were operational for the entire fiscal year to the prior performance of the related COf's provides a perspective of ACS' actual benefits and an indication of the potential capabilities of the system.

During FY 84, the four pilots collected $328 million from delinquent accounts compared to $277 million collected by the related COf's during FY82. This 18.4% increase in dollars collected was accomplished with 44.5% fewer staff years.

LEVIES

Senator PROXMIRE: I understand that collecting delinquent taxes by levying taxpayer property is an important part of IRS' collection program. You estimate that about 50 percent of the cases closed by ACS are a result of levies. The use of levies has increased substantially in the past few years. IRS used its levy powers almost 1.4 million times in fiscal year 1983, an increase of 40 percent over fiscal year 1982. Many of the alleged taxpayer complaints over the years have involved IRS' levy powers.

How many of these levies successfully resulted in the collection of delinquent taxes and how much money was collected in fiscal year 1984 as a result of levies?

MR. EGGER: We do not have specific data which indicates the percentage of notices of levy served which result in collection of delinquent taxes or how much money is collected as a result of issuing notices of levy. However, we do know that the notice of levy is a major tool in collection of deliquent taxes, and is often times the only means we have of securing payment.

DELINQUENT TAXES

SENATOR PROXMIRE: The Internal Revenue Code gives IRS six years from the date of assessment to collect delinquent taxes. After the statute of limitations expires, IRS has no legal recourse to collect these delinquencies. During fiscal year 1982, over $600 million was written off because the statute of limitations expired.

What amount of delinquent taxeswere written off in fiscal years 1983 and 1984 due to expiration of the statute of limitations?

What steps does IRS take to assure that the taxes written off are truly uncollectible? Does IRS review these accounts as they near the statute expiration date to determine collection potential? If not, why not?

Mr. EGGER: The statue expiration dollar amounts for 1983 and 1984 were not tracked by fiscal year. during calendar year 1983, $595 million was written off due to statue expiration. In calendar year 1984, $757 million was written off due to statue expiration. Both amounts represent less than 3% of total delinquencies outstanding. Beginning in FY 1985, statute expiration amounts will be tracked by fiscal year.

When an account is first determined to be uncollectible, we require mangerial review of the account and of all related documentation. In addition to this, collection has established a second level of review of cases according to specific criteria, such as dollar amount.

As a standard policy, IRS does not review all uncollectible accounts as they near the statute expiration date. We do have several systemic programs that reactivate these cases based on updated financial or locator information. Futhermore, we follow-up on accounts when there is a strong likelihood that revenue will be collected by tracking a specific action at a future date. Additionally, we do file a federal tax lien in the majority of uncollectible cases which prevents taxpayers from transferring assets prior to satisfying their tax liabilties.

EQUIPMENT REPLACEMENT PROGRAM

Senator PROXMIRE: During 1979, IRS initiated a program to modernize the computer hardware that supports the tax system. The program, called the Equipment Replacement Program, involved three projects: (1) replacing the main computers in IRS' 10 Service Centers, (2) redesigning the accounts research system which was then supported by microfilm files, and (3) modernizing the National Computer Center computers which supported master file processing. All three projects were to be completed in about 8 years beginning with FY 1980 and ending during FY 1987. These projects are supposed to provide IRS the ADP capacity and capability it will need into the 1990's.

During FY 1984 hearings before the Senate Committee on Appropriations, IRS provided a table showing that the Equipment Replacement Program would cost about $180 million to implement from FY 1980 through FY 1987. About $49 million or about 28 percent of the total cost was allocated to personnel costs.

Have the projected costs changed and if so, what are the new cost estimates? What are the total costs for each of the three projects?

Mr. EGGER: The actual equipment acquisition costs through FY 1985 and the projected equipment costs for FY 1986 and FY 1987 are identified in the following table:

ADP Equipment (Amounts in Million of Dollars)

	FY80	FY81	FY82	FY83	FY84	FY85	FY86	FY87	TOTAL
SCRS	0	0	2.5	12.5	20.0	33.3	36.2	26.5	131.1
MRS	0	0	.7	1.7	1.7	1.7	1.7	1.7	9.0
MFRS	0	0	0	1.7	1.8	2.5	.7	.8	7.1
TOTAL	0	0	3.2	15.8	23.5	37.2	38.6	29.0	147.2

In the case of SCRS, the original contract estimates in 1981 were $103.5 million.

TAX EXPENDITURES

SENATOR PROXMIRE The Treasury Department recently announced the results of its study to simplify the Tax Code. One of the major recommendations of the study was the elimination of many of the tax expenditure items included in the Code. Has IRS estimated how much would be saved in administering the tax laws if Treasury's recommendations were adopted?

MR. EGGER The Treasury Department is now reviewing its earlier proposals for tax reform. While it is very difficult to know the actual impact of any tax reform proposal until the actual statute is drafted (as distinguished from the conceptual approach of the original Treasury proposal), a quick IRS impact assessment of the Treasury proposal indicated that less than 1,200 average positions per year might be available for other necessary tax administration tasks during the first three full years of the tax reform proposal. Finally, if a "return free" tax system were to be adopted, there would be an additional resource impact.

SENATOR PROXMIRE In IRS' opinion, would elimination of tax expenditures provisions have a beneficial effect on taxpayer compliance with the tax laws?

MR. EGGER Most decidedly, yes. Taxpayers understand that income taxes are necessary to finance government activities. But their willingness to voluntarily pay these taxes depends on the belief that taxes are fair. A perception that the tax provisions are not fair could be as important as actual inequities. Taxpayers resent paying substantially more tax than "others" having the same or higher income -- even if the others reduce taxes by the use of perfectly legitimate exclusions, deductions, adjustments and credits.

TIP INCOME COMPLIANCE EFFORTS

Senator PROXMIRE: Although voluntary compliance is the cornerstone of our nation's tax system, more and more individuals are ignoring the tax laws by either not reporting or underreporting their taxable income. In an effort to revise this situation, the Congress passed TEFRA, which contained several provisions for improving tax compliance. One such provision for improving compliance dealt with placing additional reporting requirements on the food and beverage industry for the purpose of capturing underreported tip income. These additional reporting requirements have been labeled as unfair and costly by the industry.

How much additional revenues have been collected that can be directly related to the new tip reporting requirements?

Mr. EGGER: For establishments in business both in 1982 and 1983, tips reported to employers by employees increased by $1.06 billion or 108% of the 1982 reporting level.

Senator PROXMIRE: What has been the cost to IRS for identifying and collecting these additional revenues?

Mr. EGGER: So far, the cost of identifying and collecting additional revenues associated with the new tip reporting requirements has been small, about $30,000 for printing, distributing, and processing forms. The legislation required a study of the impact of these new requirements based on tax year 1983 data. Unfortunately too few returns were filed in 1983, so the study has been postponed until we receive enough 1984 returns.

Senator PROXMIRE: How effective have TEFRA's tip provisions been in curbing noncompliance?

Mr. EGGER: Prior to TEFRA, we estimated tip income reporting compliance to be approximately 16 percent. Based on the fact that more tip income is being reported to employers, we expect an increase in reporting of tip income on Forms 1040.

TAX GAP

Senator PROXMIRE: Last year IRS requested 490 average positions and $8.8 million to undertake an initiative to contain the tax gap of more than $80 billion. I am told that the agency hoped to focus compliance efforts in areas of underreporting and tax avoidance. Included in this effort were such things as doing more in-depth exams of non-farm individual businesses (as major source of unreported income); slowing the growth of appeals and tax litigation inventories; and increasing the collection of unpaid tax accounts. Well, the table at the back of your testimony shows that the tax gap will increase to $92 billion next year.

Is this an indication that your "tax gap" initiative of fiscal 1985 has been a failure, or that the "tax gap" has just outgrown the ability to control it, or both?

Mr. EGGER: No data is yet available on the results of our FY 1985 initiative in Examination, but we fully expect to generate the revenue estimated in our budget submission. As I mentioned earlier in response to Senator Abdnor's question, our tax gap projections anticipate that recent legislation and enforcement efforts will help slow the growth of the tax gap and even reduce it slightly in the short run. In the long run; however, its growth will continue due to the growth in the tax base, e.g., growth in the workforce, even if voluntary compliance is held constant. The Service hopes to minimize or reverse the present decrease in compliance and thus control the tax gap through a vigorous enforcement program, publicity and education. Tax simplification would also help us in our efforts to control the gap.

TAXPAYER SERVICE

Senator PROXMIRE: Your 1985 budget calls for an increase of 211 permanent taxpayer service positions and for detailing an additional 84 staff years from other IRS units to taxpayer service during the tax filing season on a temporary basis, I am informed. However, at the same time, your budget calls for a decrease in temporary taxpayer service positions of 353 staff positions.

Why would you be increasing permanent taxpayer service staff; detailing additional temporary staff to taxpayer service;

and then cutting temporary taxpayer service slots by 353 staff years? It doesn't seem to make sense.

Mr. EGGER: The taxpayer service program has effectively managed its staffing by maintaining a level of permanent staff sufficient to meet the needs of the lowest volume period of the year (that is, May through December). Taxpayer service has experienced an increase in the proportion of workload that falls in that period. This shift in the workload distribution through the year has necessitated an increase in the number of permanent employees. As the workload volume increases in the January through April time period, staffing is augmented with temporary employees and the additional details in from other IRS functions.

Question Submitted by Senator Ted Stevens

ORPHAN DRUG REGULATIONS

SENATOR STEVENS: On October 3rd, 1984, the Acting Assistant Secretary for Tax Policy, Ronald A. Pearlman, responded to my letter of August 10th, 1984 to Secretary Regan urging expeditious issuance of the regulations implementing the tax credit provisions of the Orphan Drug Act with the following information:

> "These regulations have been assigned to a high priority and we expect that they will be issued shortly".

As of March 27, 1985, these regulations have yet to appear in the Federal Register. Please advise the Committee of the date certain when these regulations will be finalized, and provide an explanation of the delays which have hindered these "high priority" regulations. P.L. 97-414 was enacted in 1983, and the Department's inaction in this matter is to the detriment of those individuals suffering from orphan diseases such as Tourett's Syndrome for whose benefit this legislation was enacted.

MR. EGGER: The proposed regulations were signed by the Assistant Secretary for Tax Policy on April 10, 1985, and will appear in the Federal Register the week of April 15.

Delay in proposing these regulations was caused in large part by a technical issue concerning the eligibility of biological products for the tax credit. The Orphan Drug Act allows the Food and Drug Administration to designate a biological product as an "orphan drug". However, when addressing the tax credit, the Act omits reference to biological products. The Treasury Department has proposed a technical correction to clarify that certain expenses incurred in testing biological products are eligible for the tax credit. The technical correction is a part of the proposed Technical Corrections Bill for the 1984 Tax Act.

Questions Submitted by Senator Robert C. Byrd

Martinsburg IRS Center

Senator Byrd: Mr. Egger, the Martinsburg IRS National Computer Center has a current budget of about $22 million, with a staff of approximately 463. Would you please advise what the staffing and funding levels will be in FY 1986.

Mr. Egger: Although additional workload has been absorbed at the Martinsburg IRS National Computer Center, the staffing and funding levels are expected to remain at the FY 1985 levels of 463 staff years and approximately $22 million for FY 1986.

Senator Byrd: The National Computer Center at Martinsburg has not only had a valuable and positive economic impact on the local community, it also is an integral part of the IRS system.

Would you provide for the record your long-range plans for the National Computer Center with a view toward any upgrading or expansion of the facility?

Mr. Egger: The National Computer Center (NCC) has existed as an integral part of the automated IRS Tax Administration System since the early 1960's. Since its establishment, NCC has continued to apply advanced computer technology to provide increasingly effective and efficient service to the taxpaying public. Most recently, we have centralized our Magnetic Media Reporting Program (filing of information returns on magnetic media) at NCC. This decision will lead to more consistent and responsive service to those institutions that are required to file information returns on magnetic media. Additionally, it will provide a sufficient level of future work to allow NCC to maintain its present staffing levels for some time to come.

TAX COUNSELING FOR THE ELDERLY

Senator BYRD: Mr. Egger, one of the more popular programs of the IRS is the one providing taxpayer assistance and counseling for the elderly. This program utilizes grants to non-profit organizations to pay the expenses (travel costs, etc.) of volunteers who provide tax assistance and counseling for the elderly. In the past, the committee has been very supportive of maintaining the $2 million funding level for this program. What are your plans for Fiscal Year 1986 with regard to this program?

Mr. EGGER: The Service intends to make Application Packages available to prospective 1986 Tax Counseling for the Elderly (TCE) sponsors this summer. As we have done in the past, we will evaluate all TCE proposals and select those which are determined to be best qualified for funding. IRS looks forward to a very successful Tax Counseling program in FY 1986.

Program activity in the Tax Counseling for the Elderly (TCE) program has significantly increased each year since its inception. The FY 1985 legislation directed that program funding be entirely for grants to sponsors. This departed from past

practice and placed a $700,000 burden on the IRS by requiring it to absorb administrative costs formerly covered by the funding.

Administrative expenses such as program travel, funding for the TCE volunteer hotline and publishing/distribution costs are now being absorbed by the Taxpayer Service Division budget. However, recent Taxpayer Service Division travel reductions have curtailed the Service's participation in TCE sponsors' program planning and evaluation conferences, as well as National Office visitations to TCE sites nationwide for program monitoring. If legislation continues to prohibit charging administrative costs to the TCE program, FY 1986 monitoring of sponsor activity will remain at the current FY 1985 level.

Questions Submitted by Senator Lawton Chiles

ORGANIZED CRIME DRUG ENFORCEMENT TASK FORCE BUDGET

Senator Chiles: Mr. Egger, I noticed your supplemental request for $2.4 million and 42 positions that is requested for the President's Organized Crime and Drug Enforcement Task Force in Miami. I am pleased to see your funding would focus on Miami, where it is common knowledge that the drug and crime problem is particularly acute.

However, when we look back in your budget under Investigations - Special Enforcement Programs (P. 54) where these crime and drug task force activities are funded - we notice that there is only a one position increase between FY 1985 and FY 1986.

Why is this? Is your supplemental request really just to back fill and replace IRS employees who have been on special assignment instead of being a true increase.

Commissioner Egger: The Special Enforcement Program encompasses the Organized Crime Drug Enforcement Task Forces, Organized Crime Strike Forces, High Level Drug Leaders Project, Wagering Program and Title 31. The one position increase between FY 1985 and FY 1986 is in the total budget for the Special Enforcement Program. This one position does not pertain to the Organized Crime Drug Enforcement Task Forces. There was no increase in budgeted positions in the Organized Crime Drug Enforcement Task Force Program from FY 1985 to FY 1986.

In FY 1985, the Internal Revenue Service added 42 positions for the thirteenth Organized Crime Drug Enforcement Task Force. These positions were filled by the Internal Revenue Service in the same manner in which we staffed the original twelve task forces. The Internal Revenue Service filled those positions immediately with experienced Internal Revenue Service

Special Agents who have extensive backgrounds in narcotics related investigations. We then hired new agents to back fill behind those agents we had assigned to the drug task forces.

The funding for these 42 Organized Crime Drug Enforcement Task Force positions that we added in FY 1985 is in a supplemental request to the FY 1985 budget. This supplemental request is now pending Congressional approval. Since the 42 positions for the thirteenth drug task force are already in place in FY 1985, there will not be an increase of 42 positions in the Organized Crime Drug Enforcement Task Force Program staffing or the total Special Enforcement Staffing Program for FY 1986 over that of FY 1985.

MONEY LAUNDERING
THE BANK SECRECY ACT

Senator Chiles: Since the Bank Secrecy Act was passed, IRS has investigated 700 potential violations with 238 of those investigations conducted last year. I am delighted to see the increased activity but what explains the fact that in the 15 years since the act was passed, almost 35% of the investigations were launched last year?

Commissioner Egger: The major reason for the Service not getting fully involved in the enforcement of the Bank Secrecy Act at the time of its enactment was due to the challenge by the California Bankers Association as to the constitutionality of the Act. This case was decided favorably for the government in April 1974. Shortly after this decision the Service opened its first Title 31 investigation.

In the late 1970's the Treasury Department studied the flow of currency at the Federal Reserve offices throughout the United States and discovered that an excessive and disproportionate amount of currency was being deposited in the Jacksonville and Miami Federal Reserve offices. The reason for these excessive deposits was that Miami banks were being used as a clearing point for most of the money generated from drug sales throughout the United States.

Because of this finding, the Assistant Secretary (Enforcement and Operations) initiated a departmental effort to investigate the illicit flow of currency in Florida. In late 1979, an investigation strategy was adopted and referred to as Operation Greenback. According to DEA, the estimate of money laundering in the United States during this time was $4 billion, as compared to the current estimate for 1984 of $40 billion. Also, during early 1980 the Service began initiating Financial Investigative Task Forces (FITFs) which have proven to be one of the most significant and effective investigative techniques for identifying the financiers and managers of illicit drug organizations.

Utilizing financial information available as a result of the Bank Secrecy Act, these task forces are identifying and prosecuting many previously undetected drug traffickers and money laundering specialists.

In addition, during July 1981, I began a campaign to notify the banking community of their obligations and responsibilities under the Bank Secrecy Act. Letters were sent to all FDIC insured banking institutions notifying them of the CTR filing requirements under Title 31 and explaining their responsibilities.

Finally, in 1982, when the President announced the formation of twelve regional drug task forces to deal with the increasing narcotics problem, the Service was allocated an additional 185 staff years to participate. These additional resources have also contributed significantly to the dramatic increases in investigations involving violations of the Bank Secrecy Act during the last year.

Senator Chiles: I understand that since the act passed, IRS investigations have resulted in 405 prosecutions, 281 indictments and 165 convictions. We heard from Assistant Secretary for Enforcement, John Walker, in Miami on March 15 at drug hearings that the Bank Secrecy Act should be strengthened. Assistant Secretary Walker specifically suggested that money laundering should be made a federal crime.

Commissioner Egger, what is your view? Are there specific changes that should be considered to federal law to better assist the IRS in money laundering investigations?

Commissioner Egger: I believe we should first give consideration to further strengthening our existing law before enacting new legislation.

During various Congressional hearings and through initiatives, I have already proposed various changes that would assist the IRS in money laundering investigations. Some of my proposals and views on this matter are:

A. Bank Secrecy Act Delegation to IRS

The IRS should be delegated the following responsibilities either by amendment to 31 CFR Part 103 or by a separate delegation order:

- Special authority to initiate criminal investigations on financial institutions under Federal regulation of a supervisory agency.

- Authority to grant, deny and review exemption lists from the currency transaction reporting requirements.

- Supervision of all miscellaneous financial institutions not covered under 31 CFR 103.46.

B. Addition of Forfeiture Provisions for CTRs

Presently, currency and negotiable instruments are subject to a civil forfeiture to the U.S. Government if they are not properly identified and declared on Forms 4790 in outbound and inbound transportation situations. There are no forfeiture provisions for failing to file or filing false CTRs. The addition of forfeiture provisions would give the Service a vehicle to pursue the seizure and forfeiture of liquid assets before they are disseminated to offshore havens.

C. Authority to use an Administrative Summons for Title 31

The use of an administrative summons would provide for a central summons power in the Treasury Department to facilitate enforcement of the bank secrecy law. It would enable the Treasury Department to review systematically all cash, check, wire and other transfers to offshore banks that are so frequently used to launder and conceal drug money. This, in turn, would make it much easier to track down drug traffickers and money laundering specialists.

D. Addition of an attempt to circumvent the CTR Reporting Requirements Provision

Such an attempt provision would fill an existing gap in the law, where money launderers are currently circumventing the reporting requirements. This is particularly true in some judicial districts where courts have held that no violation occurs when a money courier utilizes various branches of a financial institution or different financial institutions to conduct multiple transactions under $10,000. By adding an attempt provision it would make it more difficult for narcotics traffickers and money laundering specialists to dispose of their street currency.

E. Amend the Right to Financial Privacy Act as it relates to releasing information to law enforcement agencies

Such an amendment would permit financial institutions to notify law enforcement agencies that they have information which may be suspicious in nature or relevant to a

potential violation of law without rendering themselves open to legal liability.

INCREASED REVENUES TO THE TREASURY

Senator CHILES: Commissioner Egger, your testimony discusses a proposed fiscal year 1987 initiative to add 2,500 positions to the IRS each year for three years. You estimate that this will increase revenues by $4.6 billion. In view of our deficit problem, it is not clear why we are waiting until 1987 to begin to collect this sorely needed revenue. The sooner added revenues begin to flow into the Treasury, the better position we will be in to make progress against the deficit. Are there any reasons funding should not be provided to begin this program in FY 1986? If these resources were provided in FY 1986, what would be your revised estimates of the revenue enhancements in the next several years?

Mr. EGGER: This initiative was deferred until FY 1987 in recognition of the Administration's goal of freezing federal spending in FY 1986. If the initiative were moved up one year and resources were provided in FY 1986, revenues for FY 1986 would increase by $490 to $495 million. Eventual revenue collections resulting from this initiative would total about $5.0 billion for the period FY 1986-1989.

IMPROVED COMPLIANCE

Senator CHILES: Commissioner, your testimony shows that voluntary compliance with the tax laws has dropped from 84% in FY 1974 to an estimated 81.6% in FY 1986. This drop in compliance means the loss of billions of dollars to the Treasury, money we can ill afford to lose in our current deficit position.

How much revenue is lost for each 1% drop in voluntary compliance? In your view, what needs to be done to stop this erosion in terms of resource requirements, legislative changes, or other actions the Congress might take?

Mr. EGGER: In terms of today's tax base and compliance picture, each percentage point decline in voluntary compliance costs the Treasury $5 billion in revenue per year. From a tax administration perspective, we feel that both tax simplification and bolstered examination enforcement are necessary if we are to halt the decline in voluntary compliance.

SUBCOMMITTEE RECESS

Senator ABDNOR. If there is no further business to come before the subcommittee, we are going to stand in recess until Wednesday April 3, and we are going to be hearing from the U.S. Secret Service, Bureau of Alcohol, Tobacco and Firearms.

With that, we stand in recess.

[Whereupon, at 3:25 p.m., Thursday, March 28, the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, April 3.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

WEDNESDAY, APRIL 3, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:10 a.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, and Proxmire.

DEPARTMENT OF THE TREASURY

FEDERAL LAW ENFORCEMENT TRAINING CENTER

STATEMENT OF CHARLES F. RINKEVICH, DIRECTOR

ACCOMPANIED BY:

JOHN M. WALKER, JR., ASSISTANT SECRETARY FOR ENFORCEMENT AND OPERATIONS, DEPARTMENT OF THE TREASURY
DAVID W. McKINLEY, DEPUTY DIRECTOR
WILLIAM M. KELSO, ASSISTANT DIRECTOR, RESOURCE MANAGEMENT
JOHN C. DOOHER, ASSISTANT DIRECTOR, WASHINGTON OFFICE
GARY KOWALCZYK, ACTING DIRECTOR, OFFICE OF PLANNING, BUDGET AND PROGRAM ANALYSIS

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order.

Today, we will continue our fiscal year 1986 oversight hearings. We will be hearing from Assistant Secretary of the Treasury for Enforcement and Operations, Mr. John M. Walker, Jr.; the Director of the Federal Law Enforcement Training Center, Mr. Charles F. Rinkevich; the Director of the U.S. Secret Service, Mr. John R. Simpson, and the Director of the Bureau of Alcohol, Tobacco and Firearms, Mr. Stephen E. Higgins.

Gentlemen, I want to welcome you all to the committee. You know law enforcement is at a critical stage in this country and as much as I hate to admit it, we need to be on our guard when it comes to crime in the Nation.

I just want to say, though, for the record, that I am extremely proud of the job that the enforcement agencies and the Department of the Treasury do. Many people in the country are unaware of the job Treasury enforcement personnel are asked to perform. Your task, of course, is not an easy one, and quite frankly I am sorry we have these difficult budget times, and not providing all the resources you people need.

You need dollars, and we know that. However, I want to congratulate you and your people on a job well done with what I would term our limited resources. I would also ask that you extend the same message to the men and women of your organizations. We have a lot of pride in the work you do, and we know you are the most dedicated group of Government employees that we have.

Senator Mattingly, do you have anything you would like to add?

Senator MATTINGLY. Thank you, Mr. Chairman.

It is a pleasure to welcome Mr. Rinkevich and other members of the Training Center here today, and of course Secretary Walker. The Training Center is close to my home. It is in Brunswick, GA, and it gives me a unique perspective on the operations of the facility. I can assure my colleagues on the committee that Director Rinkevich and his staff continue to perform their complex mission at the highest levels of efficiency and accomplishment.

That is the end of my statement, Mr. Chairman, but I will have questions.

Senator ABDNOR. Very fine. We will move on, then, and as I understand it, Mr. Walker will offer an opening statement for each Bureau, to be followed by the Directors.

STATEMENT OF ASSISTANT SECRETARY WALKER

Mr. WALKER. Yes; Mr. Chairman.

I certainly appreciate the kind words of the chair with regard to Treasury law enforcement, and I would certainly be remiss if I did not compliment this committee and you, Chairman Abdnor, and Senator Mattingly for the support day in and day out that you render to Treasury law enforcement. Obviously, we could not function without you, and frankly we would not want to function without you.

Senator ABDNOR. Thank you.

Mr. WALKER. Mr. Chairman and members of the committee, it is a pleasure to appear before you today and to seek your favorable action in support of the annual appropriation for the Federal Law Enforcement Training Center for fiscal year 1986.

Before I comment on the request, I would like to introduce to the committee Charles F. Rinkevich, Director of the Federal Law Enforcement Training Center. Mr. Rinkevich is accompanied by other senior members of the Center's staff whom he will introduce later. Also in attendance with us is Gary Kowalczyk, Acting Director of the Department's Office of Planning, Budget and Program Analysis.

Senator ABDNOR. Welcome to the club here.

CONSOLIDATED TRAINING

Mr. WALKER. We in the Department of the Treasury are particularly proud of the Center, its growing list of achievements, and its contribution to the law enforcement profession. At a time when every responsible person in Government is examining alternative ways to control spending and improve cost efficiency, the Center stands out as a proven example of good Government management. The vehicle for attaining this success has been the concept of consolidation through interagency cooperation. To the American taxpayer though, the real benefit has been the Center's ability to provide superior quality training, and to do so through an exceptionally economical and efficiently run facility.

As a result of consolidation, the Center is able to provide training and support for nearly every Federal enforcement agency and, now, for an increasing number of State and local jurisdictions. As each year passes, the Center's critical role in preparing law enforcement officers to effectively execute their responsibilities seems to take on an added importance; and whether it is providing computer related training for investigators from the inspector general community or marine law enforcement training for Customs and Drug Enforcement Administration officers, the Center continues to meet the challenges asked of it.

The concept for the Center is an outgrowth of the Treasury Law Enforcement School which originally served the Treasury bureaus. However, because of Treasury's experience and willingness to share its training programs with other agencies, when the notion of operating a central site for multiagency training arose, it was only natural that Treasury was chosen to be the lead agency in developing the concept.

As a result of a memorandum of understanding with law enforcement organizations for several departments and independent agencies, the Center came into existence in 1970. That document establishes the Center's mission, which includes conducting core instructional programs as common basic or mandatory training for new Federal personnel, conducting advanced training for journeymen level personnel from several different agencies, and providing the resources for participating organizations to do their own specialized training. The enthusiasm for a consolidated approach to training has grown to the point now that 59 Federal organizations from all three branches of Government participate in Center programs.

GLYNCO, GA

Beginning in 1975, the Center has operated at its present location in Glyno, GA, a superb site for training law enforcement officers. With the cooperation of many, and particularly this committee, the Center transformed this 1,500 acre, deactivated military base into a first-rate training facility. Through the use of Glynco, the Government now realizes a savings annually of over $24 million. This figure is calculated on the fact that 59 separate Federal training efforts have consolidated into a single location, many agencies have closed other duplicative and costly facilities, and the unusual economy in per diem expenses realized from the use of this residential facility.

INCREASED WORKLOAD

During fiscal year 1984, the Center reached a new high point in the level of training conducted at Glynco. Over 14,200 students participated in basic and advanced training, which is 2,000 more than the previous year for all Center programs. The overwhelming percentage of these students attended basic police and investigator programs. In fiscal years 1985 and 1986, this upward trend is expected to continue based upon present projections from the Center's clientele agencies. Due in part to the strain of the increased workload on the Glynco facility, and to the Department of the Interior's request for the Center to manage the Bureau of Indian Affairs [BIA] training programs, Treasury has approved the use of a leased satellite location at Marana, AZ. As we reported to this committee in an earlier letter, it is our intention that this training be conducted on a reimbursable basis, and that no effort be made to replicate the unique facilities already existing at Glynco. This request by the BIA is, again, evidence of the growing reputation of the Center for quality training and efficient management.

With respect to one other programmatic responsibility, let me mention that the Treasury Department continues to be pleased with the progress being made by the National Center for State and Local Law Enforcement Training at Glynco. As you recall, President Reagan established this activity in 1982 as part of a strategy to better coordinate Federal, State, and local authorities in the fight against crime. To that end the Center now is offering over 20 selected, specialized training programs and has provided training to over 2,000 officers from nearly every State and U.S. possession. This action has been a cooperative effort with the Department of Justice and we have appreciated their assistance in the form of personnel and funding for the development of several programs.

FISCAL YEAR 1986 APPROPRIATION REQUEST

The pending appropriation request for the Center in fiscal year 1986 is $17,500,000, or approximately 5 percent below the fiscal year 1985 continuing resolution level. This request is made in recognition and support for fiscal restraint by the Federal Government. With this funding level, the Center can continue to meet its primary mission responsibilities. As in the past, the Center expects that other training requirements will be accommodated on a reimbursable basis.

Together with the support of this committee, the Treasury Department stands committed to maintaining the Federal Law Enforcement Training Center as one of its most important bureaus and to continuing the tradition of excellence in service to the entire law enforcement community.

I will now ask Director Rinkevich to provide further detail on the Center's operations and funding request, and at the conclusion of his statement we will be glad to answer any questions you or members of the committee may have.

Senator ABDNOR. Thank you.

Mr. Rinkevich, welcome to the committee. I see you have a lengthy statement. You may summarize it, if you wish.

Mr. RINKEVICH. Thank you, Mr. Chairman.

STATEMENT OF MR. RINKEVICH

Mr. Chairman and members of the committee, I am pleased to be here today to report on the operations of the Federal Law Enforcement Training Center and to support our appropriation request for fiscal year 1986.

INTRODUCTION OF WITNESSES

At this time, I would like to introduce the representatives of the Center who have accompanied me: David W. McKinley, Deputy Director; William M. Kelso, Assistant Director for Resource Management, and John C. Dooher, Assistant Director for our Washington office.

OPENING REMARKS

In the 2 years that I have been associated with the Center, I have strenghtened my belief in the benefits and advantages of consolidating the training of Federal law enforcement personnel at Glynco. My appreciation for the professionalism and innovative approaches displayed by Center staff in developing our various training programs and facilities to their current level of excellence has also grown significantly. Our achievements this past year are many, and I am pleased to briefly acquaint you with them.

The experiment which this subcommittee set in motion over 17 years ago, the operation of a consolidated training center for Federal law enforcement personnel, is a success. The Center provides high quality training for our Nation's law enforcement officers, and we do it on a continuing basis at the lowest possible cost.

The degree to which the Center has become the focal point for Federal law enforcement training is further illustrated by the fact that 17 of our 59 participating organizations now maintain permanent staff at the Center to assist in the basic training of their personnel and also to conduct advanced training to meet their specific statutory or mission responsibilities. These organizations did not relocate or establish these offices simply to maintain a presence at the Center, but did so to take advantage of the excellent and economical programs, facilities, and support services provided. The cost effectiveness of operating a consolidated resident training center has never been more obvious than during this current period of fiscal restraint. For example, one of our greatest savings is in the cost of housing and feeding students. The current per diem rate in Washington and other major cities is $75, while the Center is able to house and feed students for $21.05 per day.

The fact that the Center has been able to effectively respond to the training needs of the growing number of participating organizations also attests to the soundness of the consolidated training concept. Glynco's

ability to steadily expand its operations to accommodate multiple agency requirements during a period of fiscal restraint is due to the deliberate exploitation of the economies of scale which are a consequence of a consolidated center.

During the remainder of my remarks, I will further amplify on the trends and other specific achievements and goals I believe will be of interest to you.

FISCAL YEAR 1986 APPROPRIATION REQUEST

The fiscal year 1986 budget request for the Federal Law Enforcement Training Center is $17,500,000. This represents a decrease of $841,000, or approximately 5 percent less than the fiscal year 1985 proposed level of $18,341,000, and provides funds for 17 percent of basic training requirements. The remainder of basic training requirements will be met on a reimbursable basis. The Center supports established policy among Federal law enforcement agencies that new recruits shall not be given permanent on-the-street assignments until they have completed basic training. The total budget for the Center is estimated to be $28,800,000 in fiscal year 1986. This includes the $17,500,000 in this budget request as well as all reimbursements for basic training in the amount of $8,648,000, and reimbursement for advanced training in the amount of $2,652,000.

CATEGORIES OF TRAINING

There are three categories of training conducted at the Center. These are: Basic or mandatory training for entry level personnel, advanced training for journeyman level personnel, and selected specialized training provided to State and local officers.

In the aggregate, the Center graduated 14,255 students in fiscal year 1984, and we expect to have 21,112 graduates in fiscal year 1985. Our fiscal year 1985 training represents a mix of 73 percent basic and 27 percent advanced, with State and local officers accounting for 3 percent of the advanced training. We anticipate 22,035 graduates in fiscal year 1986, based on participating organization projections. In fiscal year 1986, we project a mix of 70 percent basic and 30 percent advanced, with State and local officers again being 3 percent of the advanced.

BASIC TRAINING

The basic training programs for investigators and officers conducted by the Center range in length from 5 to 17 weeks. During fiscal year 1984, a total of 6,340 students graduated from basic programs. We anticipate 8,120 graduates in fiscal year 1985 and 8,427 in fiscal year 1986. Within the category of basic training there are three kinds of training, including criminal investigator, police, and followon.

During fiscal year 1984, 1,242 students were trained in the basic 7-week Criminal Investigator Program. In fiscal year 1985, we will train 1,275 students, and in fiscal year 1986 we project 2,031 students. The majority of this increase is due to projected new hiring by the agencies,

continuation of the narcotics task forces, and the addition of the inspector general community as participating organizations at the Center.

The 12 different basic training programs for uniformed police officers graduated 1,893 students in fiscal year 1984, and we project 3,763 students will graduate from the 12 different police programs during fiscal year 1985. This increase in fiscal year 1985 is due primarily to a substantial number of new hires by the U.S. border patrol.

FOLLOWON BASIC TRAINING

Several organizations conduct additional agency-specific training at Glynco for their entry level employees. This followon basic training is provided after an employee has completed a basic program, and during the first year of a probationary period. During fiscal year 1984, 3,205 students received this training and an estimated 3,082 students will receive followon basic training in fiscal year 1985. In fiscal year 1986, we expect to train an estimated 3,814 students in these programs.

ADVANCED TRAINING

Another major category of training conducted at Glynco is in advanced programs. There are over 200 of these programs conducted by both the Center and the individual participating organizations.

The Center conducts advanced training for journeymen investigators and police officers in subjects that are common to two or more organizations. During fiscal year 1984, these programs accounted for 1,026 graduates. In fiscal year 1985, 2,418 students are estimated, and in fiscal year 1986 projections are for 2,152 students. Typical programs include officer safety and survival, driver instructor training, and firearms instructor training. Many of these students also will attend the 2-week White Collar Crime Program, the 1-week Procurement and Contract Fraud Program, the 2-week Computer Fraud Program, and the GRID microcomputer training programs.

The Center offers each participating organization the opportunity to develop and conduct advanced training at Glynco to meet the specific needs of its personnel. This training is conducted by the organization's instructional staff, with assistance provided by Center faculty as requested. All administrative and logistical support for this training is provided by the Center. In fiscal year 1985, 8,735 students are projected to be trained; and 9,458 in fiscal year 1986.

STATE AND LOCAL TRAINING

The third major cateogy of training offered at Glynco is that which is provided in support of State and local police. Under the auspices of the National Center for State and Local Law Enforcement Training, over 20 specialized programs are offered to State and local officers. Every State and most territories are participating in this valuable component of the administration's crime control effort and the programs have been very well received by our State and local colleagues.

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In fiscal year 1984, 1,202 State and local students received this training; 1,839 are expected to be trained in fiscal year 1985, and 1,998 in fiscal year 1986. Consistent with our commitment not to denigrate the Center's capacity for Federal training, some of these officers will be trained at Glynco on a space-available basis, while others will be trained on an export basis at sites across the country.

The training provided to State and local officers is the type not readily available elsewhere in the country and which requires a blend of Federal, State, and local law enforcement expertise.

NEW PARTICIPATING ORGANIZATIONS

During fiscal year 1984, the Center welcomed nine more organizations to Glynco. The Central Intelligence Agency requested participation status in May 1984 for their security police force. This request resulted from the congressionally authorized CIA decision to create their own security protective force whose duties are limited to the physical protection of CIA facilities and the personnel who work in them. In September 1984 the Center's Board of Directors approved the CIA request with the understanding that their training at Glynco will be strictly limited to the facility security force. I might add that their first class of 24 students graduated on February 1, 1985.

I should also like to mention that in February 1984 the Center's Board of Directors approved a resolution which permitted the President's Council on Integrity and Efficiency [PCIE] to become a participating organization at the Center. This action was taken in order to afford eight inspectors general organizations an opportunity to have full participatory status at the Center. This means that, with respect to priority allocation of training spaces and Center payment of training expenses, the inspector general personnel represented by the PCIE are now on the same footing as the personnel of the other participating Federal organizations. Prior to this action by the Board, these IG officers did not have such status. Now, all 17 statutory inspectors generals can participate in Center programs.

With these additions, the Center has grown from a family of 50 to 59 participating organizations. This is in contrast to the time when the Center relocated to Glynco and had only 26 participating organizations.

ADP MODERNIZATION

In the last year, we have taken significant steps to utilize ADP technology as a training tool, to train investigators to use it as an investigative tool, and to use it at Glynco as a training management tool.

As an early step in this process, we established the computer and economic crime branch within our faculty. This centralization has given an organizational focus to our efforts so that we could develop and present five new programs to train investigators to use the computer as a tool in combatting white collar crime or to train the investigators in techniques to investigate crimes committed through the use of a computer.

Another aspect of our initiative to modernize the Center's use of ADP technology was to avail ourselves of assistance from the private sector council. The private sector council, an outgrowth of the Grace Commission, is a broker of private corporations willing to provide pro bono consulting services to the executive branch to improve Government operations.

Two exciting examples of using ADP as a training tool are the Center's current experimentation with computerized interactive videodisc training in cardiopulmonary resuscitation [CPR] and our development of a computerized laser judgment pistol shooting [JPS] system. We have begun the integration of the CPR system into our Training Program and thus far it has proven effective. Through this system, the student is able to receive standardized instruction, instant feedback, learning reinforcement, and it extends the capability of our regular faculty in teaching lifesaving techniques.

We also plan to utilize ADP technology for student and faculty learning labs, facility and program evaluation, and student testing. Other specific examples might be the utilization of the computer to present basic legal concepts and radio communication procedures to students, as well as many other subject matter applications bounded only by the skill and imagination of our faculty.

MARANA (INDIAN POLICE ACADEMY)

In May 1984 the Department of the Interior's Bureau of Indian Affairs requested that the Center manage the Training Program for their officers at a new location, the Pinal Air Park, near Marana, AZ. This request resulted from the BIA decision to close their training academy in Brigham City, UT, and their desire to avail themselves of the economies, expertise, and the creditability provided by the Center. Because Marana was a contractor-operated facility already being utilized for fire suppression training by other Federal agencies, the Center was able to negotiate an expansion of its capability to provide cost-effective law enforcement training facilities for the BIA. We also plan to use Marana for selected short term, advanced training where its location would be cost effective, and when the special training facilities of Glynco are not required.

Marana will not duplicate Glynco, but supplement it, and it will remain a contractor-operated facility with the Center's investment there being a limited number of staff and certain training equipment, both of which are portable. All other services and facilities are contractor provided, and at the present all training being conducted there is on a fully reimbursable basis with the agency receiving the training bearing the cost.

PLANT OPERATIONS

The Center consists of 1,500 acres, with over 100 buildings containing 1.4 million square feet of space and with a replacement value of $100 million.

In fiscal year 1979, the House and Senate Appropriations Committees instructed the Center to use previously appropriated constructions funds for ongoing requirements for repairs, alterations, minor construction, and equipment for facilities at Glynco. These funds will be fully obligated very soon. Beginning with our fiscal year 1985 budget, it is now necessary for the Center to rely on the salaries and expenses appropriation for these requirements, and a $2.1 million line item is included in our proposed fiscal year 1985 funded level. The estimated cost for remodeling, alternation, repair, minor construction, equipment, and furnishings for fiscal year 1986 is again $2.1 million.

CLOSING REMARKS

Mr. Chairman, in closing, I want you to know that I support the efforts of the administration and this committee to reduce Government expenditures. At the same time, I appreciate the responsibility we have to provide the best possible training to the men and women who enforce our Nation's laws. Substantial savings are already being realized through the operation of the Center as a consolidated training facility, and we are confident that our programs are meeting the needs of the participating organizations. Our budget request reflects a concern for fiscal restraint as well as a commitment to high quality training.

Mr. Chairman and members of the committee, it is a pleasure for me to present the fiscal year 1986 appropriation request for the Federal Law Enforcement Training Center. I recognize that the success we have enjoyed in our effort to provide high quality training at the lowest possible cost has been made possible by your enthusiastic support and the excellent cooperation of the many law enforcement organizations we serve. We look forward to your continued support and guidance as we face the challenges that lie ahead.

My colleagues and I are available to answer any questions you may have concerning this appropriation.

PREPARED STATEMENT

Senator ABDNOR. Thank you, Mr. Rinkevich, for that very fine statement, and you do have a fine statement there.

Before we start with some questions, I am going to place your statement in the record.

[The statement follows:]

STATEMENT OF CHARLES F. RINKEVICH

Introduction

Mr. Chairman and Members of the Committee, I am pleased to be here today to report on the operations of the Federal Law Enforcement Training Center and to support our appropriation request for Fiscal Year 1986.

At this time, I would like to introduce the representatives of the Center who have accompanied me: David W. McKinley, Deputy Director; William M. Kelso, Assistant Director for Resource Management; and John C. Dooher, Assistant Director for our Washington Office.

In the two years that I have been associated with the Center, I have strengthened my belief in the benefits and advantages of consolidating the training of Federal law enforcement personnel at Glynco. My appreciation for the professionalism and innovative approaches displayed by Center staff developing our various training programs and facilities to their current level of excellence has also grown significantly. Our achievements this past year are many, and I am pleased to briefly acquaint you with them.

The experiment which this subcommittee set in motion over 17 years ago, the operation of a consolidated training Center for Federal law enforcement personnel, is a success. The Center provides high quality training for our Nation's law enforcement officers and we do it on a continuing basis at the lowest possible cost.

The degree to which the Center has become the focal point for Federal law enforcement training is further illustrated by the fact that 17 of our 59 participating organizations now

maintain permanent staff at the Center to assist in the basic training of their personnel and also to conduct advanced training to meet their specific statutory or mission responsibilities. These organizations did not relocate or establish these offices simply to maintain a presence at the Center, but did so to take advantage of the excellent and economical programs, facilities and support services provided. The cost effectiveness of operating a consolidated resident training Center has never been more obvious than during this current period of fiscal restraint. For example, one of our greatest savings is in the cost of housing and feeding students. The current per diem rate in Washington and other major cities is $75.00, while the Center is able to house and feed students for $21.05 per day.

The fact that the Center has been able to effectively respond to the training needs of the growing number of participating organizations also attests to the soundness of the consolidated training concept. Glynco's ability to steadily expand its operations to accommodate multiple agency requirements during a period of fiscal restraint is due to the deliberate exploitation of the economies of scale which are a consequence of a consolidated Center.

During the remainder of my remarks, I will further amplify on the trends and other specific achievements and goals I believe will be of interest to you.

Salaries and Expenses

A substantial investment has been made in the staff, facilities and the training programs at Glynco; and the record reflects that the Center has been successful in providing high quality training at less cost than would be otherwise possible.

This year's budget has been carefully tailored to represent only the highest priority needs of the Center; it is a "hold the line" budget, consistent with the Administration's deficit reduction efforts.

The FY 1986 budget request for the Federal Law Enforcement Training Center is $17,500,000. This represents a decrease of $841 thousand, or approximately 5% less than the FY 1985 proposed level of $18,341,000 and provides funds for 17% of basic training requirements. The remainder of basic training requirements will be met on a reimbursable basis. The Center supports established policy among Federal law enforcement agencies that new recruits shall not be given permanent "on-the-street" assignments until they have completed basic training. The total budget for the Center is estimated to be $28,800,000 in FY 1986. This includes the $17,500,000 in this budget request as well as all reimbursements, for basic training in the amount of $8,648,000 and for advanced training in the amount of $2,652,000.

This budget request includes funds to train 1,400 students in basic programs, representing 10,452 student weeks, for an Average Resident Student Population of 201. In addition, based on the information currently available from the participating organizations the Center also will train 7,027 Basic students, representing 49,491 student weeks and 13,608 Advanced students, representing 26,072 student weeks on a totally reimbursable basis. Combined, this training reflects an Average Resident Student Population of 1,654. Based on previous years' experience, we anticipate that these projections will be adjusted in accordance with each participating organization's actual budget authorization.

Types of Training

There are three categories of training conducted at the Center. These are: Basic or mandatory training for entry level personnel, Advanced training for journeyman level personnel, and selected specialized training provided to State and local officers.

In the aggregate, the Center graduated 14,255 students in FY 1984, and we expect to have 21,112 graduates in FY 1985. Our FY 1985 training represents a mix of 73% basic and 27% advanced, with State and local officers accounting for 3% of the advanced training. We anticipate 22,035 graduates in FY 1986, based on participating organization projections. In FY 1986, we project a mix of 70% basic and 30% advanced, with State and local officers again being 3% of the advanced.

Basic Training

The basic training programs for investigators and officers conducted by the Center range in length from 5 to 17 weeks. During Fiscal Year 1984, a total of 6,340 students graduated from basic programs. We anticipate 8,120 graduates in FY 1985 and 8,427 in FY 1986. The Center's training staff and faculty continue to improve existing programs, to develop new programs to meet changing requirements, and to accommodate the training needs of additional participating organizations. Within the category of Basic training there are three kinds of training, including Criminal Investigator, Police, and Follow-on.

Criminal Investigator Training - During FY 1984, 1,242 students were trained in the basic 7-week Criminal Investigator program. In FY 1985, we will train 1,275 students, and in FY 1986, we project 2,031 students. The majority of this increase

is due to projected new hiring by the agencies, continuation of the narcotics task forces, and the addition of the Inspector General community as participating organizations at the Center.

Police Training - The basic training programs for uniformed police officers graduated 1,893 students during FY 1984 and we project 3,763 students will graduate from the 12 different police programs during FY 1985. This increase in FY 1985 is due primarily to a substantial number of new hires by the U.S. Border Patrol. In FY 1986, we will train an estimated 2,582 police recruits. The police programs vary in length and content due to the range of police functions performed in the Federal government.

Follow-on Basic Training - Several organizations conduct additional agency specific training at Glynco for their entry level employees. This Follow-on Basic training is provided after an employee has completed a basic program, but during the first year of a probationary period. During FY 1984, 3,205 students received this training and an estimated 3,082 students will receive follow-on basic training in FY 1985. In FY 1986, we expect to train an estimated 3,814 students in these programs.

Advanced Training

Another major category of training conducted at Glynco is in Advanced programs. There are over 200 of these programs conducted by both the Center and the individual participating organizations.

Center Conducted Advanced Training - The Center conducts advanced training for journeymen investigators and police officers in subjects that are common to two or more organizations. During FY 1984, these programs accounted for 1,026

graduates. In FY 1985 2,418 students are estimated, and in FY 1986, projections are for 2,152 students. Typical programs include Officer Safety and Survival, Driver Instructor Training, and Firearms Instructor Training. Many of these students also will attend the two-week White Collar Crime Program, the one-week Procurement and Contract Fraud Program, the two-week Computer Fraud Program, and the GRiD Microcomputer training programs. These programs support investigators, including those employed by the various Inspectors General, in their efforts to investigate White Collar Crime generally, and waste, fraud, and abuse in Federal programs.

During the remainder of FY 1985, we will continue the development of programs to meet the needs of participating organizations in two new areas: Law Enforcement Spanish Training and Technical Investigative Equipment

The Law Enforcement Spanish Training Program is designed to develop an officer's ability to understand the general drift of conversations with Spanish speaking citizens in a law enforcement context and to make simple, understandable, appropriate responses. A total immersion methodology is used with a heavy emphasis on student participation.

The Technical Investigative Equipment Program is designed to be a comprehensive approach to aiding the investigator in the legal use and application of technical surveillance equipment; agents will learn how to handle, operate, maintain and repair this sophisticated investigative equipment.

Agency Conducted Advanced Training - The Center offers each participating organization the opportunity to develop and conduct advanced training at Glynco to meet the specific needs of its personnel. This training is conducted by the organization's

instructional staff, with assistance provided by Center faculty as requested. All administrative and logistical support for this training is provided by the Center. This unique arrangement allows participating organizations to meet their special training requirements and, at the same time, benefit from our expert faculty, superb facilities, and the substantial cost savings available through consolidation. In FY 1984, 5,687 students received this type of advanced training; 8,735 students are projected to be trained in FY 1985; and 9,458 in FY 1986.

State and Local Training

The third major category of training offered at Glynco is that which is provided in support of State and local law enforcement. Under the auspices of the National Center for State and Local Law Enforcement Training, over 20 advanced, specialized programs are offered to State and local law enforcement officers. Every State and most territories are participating in this valuable component of the Administration's crime control effort and the programs have been very well received by our State and local colleagues.

In FY 1984, 1,202 State and local students received this training; 1,839 are expected to be trained in FY 1985; and 1,998 in FY 1986. Consistent with our commitment not to denigrate the Center's capacity for Federal training, some of these officers will be trained at Glynco on a space available basis, while others will be trained on an export basis at sites across the country.

The training provided to State and local officers is the type not readily available elsewhere in the country and which requires a blend of Federal, State and local law enforcement expertise.

Finally, I would like to mention that the Center has participated in a State Department sponsored Anti-terrorism Assistance Program for foreign personnel. In November 1983, Congress approved the Anti-Terrorism Assistance Program. In cooperation with the State Department, the Center and several other agencies provide orientations to foreign delegations concerning our individual training capabilities. As this program evolves, we may be asked by State to provide limited training on a space available, reimbursable basis to friendly countries in anti-terrorism related subjects. As a side benefit, the program continues to provide new and intensified contacts between U.S. officials and the security officials of host governments.

Productivity Improvements

We have been able to increase our productivity, without increasing our staff, through a number of improvements. For example, our administrative word processing system has continued to expand to meet the needs of the various training and support units of the Center and we are utilizing microcomputer technology to prepare and administer the budget.

The Center's primary mission, of course, is training law enforcement personnel, and in fiscal year 1984, we realized substantial overall productivity gains in this principal mission area. I am proud to state that we provided approximately 29% more student weeks of training in FY 1984 than in FY 1983. This is a direct result of the continued dedication and professionalism of our faculty and staff, who are meeting the challenge to provide more quality training without a commensurate increase in resources.

New Participating Organizations

During Fiscal Year 1984, the Center welcomed nine more organizations to Glynco. The Central Intelligence Agency requested participation status in May 1984 for their Security Police Force. This request resulted from the Congressionally authorized CIA decision to create their own Security Protective Force whose duties are limited to the physical protection of CIA facilities and the personnel who work in them. In September 1984, the Center's Board of Directors approved the CIA request with the understanding that their training at Glynco will be strictly limited to the facility security force. I might add that their first class of 24 students graduated on February 1, 1985.

I should also like to mention that in February 1984, the Center's Board of Directors approved a resolution which permitted the President's Council on Integrity and Efficiency (PCIE) to become a participating organization at the Center. This action was taken in order to afford eight Inspectors General organizations an opportunity to have full participatory status at the Center. This means that, with respect to priority allocation of training spaces and Center payment of training expenses, the Inspector General personnel represented by the PCIE are now on the same footing as the personnel of the other participating Federal organizations. Prior to this action by the Board, these IG offices did not have such status. Now all 17 statutory Inspectors General can participate in Center programs.

With these additions, the Center has grown from a family of 50 to 59 participating organizations. This is in contrast to the time when the Center relocated to Glynco and had only 26 participating organizations.

Automated Data Processing (ADP) Modernization

The Center is proud of its accomplishments in pursuing the advantages of the latest technology in information systems applications, microcomputers, telecommunications and word processing systems. However, we know that the field of Automated Data Processing (ADP) is moving so rapidly that for us to take full advantage of the technology in law enforcement training, we must establish an ADP center of excellence at Glynco. We are doing so now.

In the last year, we have taken significant steps to utilize ADP technolcgy as a training tool, to train investigators to use it as an investigative tool, and to use it at Glynco as a training management tool.

The Center has placed a priority on training investigators to develop and maintain state-of-the-art knowledge in computer technology as an investigative tool. As an early step in this process, we established the Computer and Economic Crime Branch within our faculty. This centralization has given an organizational focus to our efforts so that we could develop and present five new programs to train investigators to use the computer as a tool in combatting white collar crime or to train the investigators in techniques to investigate crimes committed through the use of a computer. Four of these programs utilize the GRID microcomputer and include a Basic, Advanced, Executive and Graphics training program. The fifth program is a two-week Computer Fraud Training Program.

Another aspect of our initiative to modernize the Center's use of ADP technology was to avail ourselves of assistance from the Private Sector Council. The Private Sector Council, an outgrowth of the Grace Commission, is a broker of private

corporations willing to provide pro bono consulting services to the Executive Branch to improve Government operations. In our case, an expert computer consultant has been assigned to assist the Center in developing a five-year plan for the enhancement of our entire computing capability--with emphasis on training systems. Flowing from this plan will be specific decisions to insure state-of-the-art training equipment and techniques are provided to the law enforcement community.

Two exciting examples of using ADP as a training tool are the Center's current experimentation with computerized interactive videodisc training in cardiopulmonary resuscitation (CPR) and our development of a computerized Laser Judgment Pistol Shooting (JPS) System. We have begun the integration of the CPR system into our training program and thus far it has proven effective. Through this system, the student is able to receive standardized instruction, instant feedback, learning reinforcement, and it extends the capability of our regular faculty in teaching life saving techniques.

The computerized Judgment Pistol Shooting System, which I am proud to note Center faculty and staff developed, has been a significant breakthrough in the field of firearms training. Although we are still refining the system, its capabilities are significant. The system, integrating laser technology with interactive videodisc capability, projects a student into various life-like scenarios requiring him to make a decision whether to shoot or not to shoot. Once the decision is made, instant feedback is provided letting the student know if the decision was accurate or not. Instant replays are also possible, and a printout of the student's score on judgment and accuracy is provided.

We also plan to utilize ADP technology for student and faculty learning labs, facility and program evaluation and student testing. Other specific examples might be the utilization of the compu'er to present basic legal concepts and radio communication procedures to students, as well as many other subject matter applications bounded only by the skill and imagination of our faculty.

As part of our training support system, the Center will modernize and integrate existing administrative ADP capability with other much needed improvements such as management information systems; tracking of individual students and classes throughout their stay at FLETC; automating a difficult, expensive and time consuming class scheduling process; and developing highly automated financial management and inventory control systems.

When our plans come to fruition, Glynco will truly have an ADP Center of excellence!

Marana (Indian Police Academy)

In May 1984, the Department of Interior's Bureau of Indian Affairs (BIA) requested that the Center manage the training program for their officers at a new location, the Pinal Air Park, near Marana, Arizona. This request resulted from the BIA decision to close their training academy in Brigham City, Utah, and their desire to avail themselves of the economies, expertise and the creditability provided by the Center. Because Marana was a contractor operated facility already being utilized for fire suppression training by other Federal agencies, the Center was able to negotiate an expansion of its capability to provide cost-effective law enforcement training facilities for the BIA. We also plan to use Marana for selected short term, advanced

training where its location would be cost effective, and when the special training facilities of Glynco are not required.

Marana will not duplicate Glynco but supplement it, and it will remain a contractor-operated facility, with the Center's investment there being a limited number of staff and certain training equipment, both of which are portable. All other services and facilities are contractor provided, and at the present, all training being conducted there is on a fully reimbursable basis with the agency receiving the training bearing the cost. The first 10 week Basic BIA program began in January 1985 and is scheduled for completion in mid March 1985.

Plant Operations

The Center consists of 1,500 acres, with over 100 buildings containing 1.4 million square feet of space and with a replacement value of $100 million. It is a "special use" facility and, therefore, GSA is not involved in facility operations or maintenance. It is Center management's responsibility to assure that adequate funds are available to accomplish needed routine maintenance and also to deal with emergency repair.

In Fiscal Year 1979, the House and Senate Appropriations Committees instructed the Center to use previously appropriated construction funds for ongoing requirements for repairs, alterations, minor construction and equipment for facilities at Glynco. These funds will be fully obligated very soon. Beginning with our Fiscal Year 1985 budget, it is now necessary for the Center to rely on the Salaries and Expenses appropriation for these requirements, and a $2.1 million line item is included in our proposed FY 85 funded level. The estimated cost for remodeling,

alteration, repair, minor construction, equipment and furnishings for fiscal year 1986 is again $2.1 million.

Because the Government has invested a substantial sum in the creation of up-to-date training facilities at the Center, we believe that it is very important for these facilities to be timely maintained in a responsible fashion.

Organizational Reassessment

During 1984, I commissioned an internal study group to review Center operational and administrative activities and, as appropriate, to offer recommendations to improve our efficiency and effectiveness. This group has completed their study, and at this time, I have their recommendations under consideration. While the proposed changes do not affect our FY 1986 Budget, I did want this Committee to know that like any viable organization, from time to time, it is necessary for the Center to fine tune its organization and redefine relationships within it.

Closing

Mr. Chairman, in closing, I want you to know that I support the efforts of the Administration and this Committee to reduce Government expenditures. At the same time, I appreciate the responsibility we have to provide the best possible training to the men and women who enforce our Nation's laws. Substantial savings are already being realized through the operation of the Center as a consolidated training facility, and we are confident that our programs are meeting the needs of the participating organizations. Our budget request reflects a concern for fiscal restraint as well as a commitment to high quality training.

Mr. Chairman and Members of the Committee, it is a pleasure for me to present the Fiscal Year 1986 appropriation request for the Federal Law Enforcement Training Center. I recognize that the success we have enjoyed in our effort to provide high quality training at the lowest possible cost has been made possible by your enthusiastic support and the excellent cooperation of the many law enforcement organizations we serve. We look forward to your continued support and guidance as we face the challenges that lie ahead.

My colleagues and I are available to answer any questions you may have concerning this appropriation.

IMPACT OF REDUCTION IN APPROPRIATION

Senator ABDNOR. I am going to call on Senator Mattingly. He is our expert in this area. I know he reminds us of it.

Senator MATTINGLY. Thank you, Mr. Chairman.

I appreciate your letting me go first, because I do have another meeting I have to go to.

Mr. Rinkevich, you and Secretary Walker indicate that the total number of graduates from training center programs is expected to increase from an estimated 21,112 in the current fiscal year to 22,035 in fiscal year 1986, yet the budget request of the administration is $17.5 million, a decrease of about 5 percent.

How can the Center reconcile the increased student load with the decreased operating budget?

Mr. WALKER. Essentially, the savings will be accomplished by having more of the basic training conducted on a reimbursable basis than is presently the case.

As you know, of the basic training that exists today, a portion of it is covered by appropriated funds from this committee and the cost of the remaining basic training is reimbursed by the participating agencies.

The difference would be basically made up by more reimbursement than we have today. Those precise figures can be provided by Mr. Rinkevich.

Senator MATTINGLY. Thank you.

[The information follows:]

FISCAL YEAR 1986 TRAINING

Training type	Students	Student weeks	Cost
Basic:			
Appropriated	1,400	10,452	[1] $3,055,000
Reimbursable	7,027	49,490	6,735,000
Subtotal	8,427	59,942	9,790,000
Advanced:			
Appropriated	0	0	0
Reimbursable	11,610	23,523	4,167,000
Subtotal	11,610	23,523	4,167,000
State and local:			
Appropriated	0	0	0
Reimbursable	1,998	2,549	452,000
Subtotal	1,998	2,549	452,000
Total:			
Appropriated	1,400	10,452	[1] $3,055,000
Reimbursable	20,635	75,562	11,354,000
Subtotal	22,035	86,014	14,409,000

[1] Basic training funding does not include the cost of student travel to and from the Center.

FBI/DEA MERGER ISSUE

Senator MATTINGLY. I know you may not want to get into this swamp, but I want you to provide the subcommittee information you might have relating to the unofficial reports that the Training Center activities of the DEA, Drug Enforcement Administration, might be merged with those of the FBI at Quantico, VA. I don't know what information you have. I would like to provide for the record a copy of my letter to Attorney General Ed Meese; the response from the U.S. Department of Justice, and an article that was printed in the Washington Post, concerning this matter.

Senator ABDNOR. It will be made part of the record.

[The information follows:]

LETTER FROM HON. MACK MATTINGLY, U.S. SENATOR FROM GEORGIA

MARCH 22, 1985.

The HONORABLE EDWIN MEESE,
Attorney General, Department of Justice, Washington, DC

DEAR ED: I have been advised by officials of the Drug Enforcement Agency [DEA] that they are currently gathering information on an in-house proposal that would move DEA personnel training operations from their current location at the Federal Law Enforcement Training Center [FLETC] in Brunswick, GA, to the Quantico, VA, facility used by the Federal Bureau of Investigation.

Let me assure you of my support of any administrative or management reorganization effort that would significantly enhance the efforts being made to reduce the threat posed by illicit drug trafficking.

However, one of the primary reasons for consolidating all Federal law enforcement training activities at the FLETC was to create a cohesion among all Federal law enforcement personnel. In my view, any exception to current policy should be approved only if thorough examination finds clear evidence that such a move would result in

better training for the agents at a reduced cost to the taxpayer with resulting enhanced capability to combat the flow of drugs in our Nation.

I hope that we will have an opportunity to discuss this at an early date.

Sincerely,

MACK MATTINGLY,
U.S. Senator.

LETTER FROM PHILLIP D. BRADY, ACTING ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE

MARCH 25, 1985.

Hon. MACK MATTINGLY,
U.S. Senate, Washington, DC

DEAR SENATOR MATTINGLY: This is to acknowledge receipt of your letter of March 22, 1985, to the Attorney General, received by the Department on March 25, 1985, concerning the possible relocation of DEA personnel from the Federal Law Enforcement Training Center in Brunswick, GA.

A further response will be forthcoming as soon as possible.

Sincerely,

PHILLIP D. BRADY,
Acting Assistant Attorney General.
(By) MICHAEL W. DOLAN,
Deputy Assistant Attorney General,
Office of Legislative and Intergovernmental Affairs.

(From the Washington Post, Sat., Feb. 16, 1985)

DEPARTING ATTORNEY GENERAL LEAVES QUESTION IN HIS WAKE

DEA, FBI DENY BOOKLET'S CLAIM THAT THEY MERGED

(By Loretta Tofani, Washington Post Staff Writer)

In a glossy swan-song booklet to his employees, William French Smith described some of his proudest accomplishments as Attorney General, among them the merger of the Drug Enforcement Administration into the Federal Bureau of Investigation.

Merger? The FBI and DEA deny that it occurred. Their parent Justice Department insists that it did.

"No, they haven't," said FBI spokesman Lane Bonner when asked whether the two organizations had merged.

"They definitely have not merged," said DEA spokesman Bob Feldcamp.

"It must have have been a mistake by one of those public relations people," added a DEA agent who did not want to be identified. But Tom DeCair, Smith's spokesman, said there was no mistake. "It's a matter of semantics."

DeCair said the booklet was written by aides who "checked their facts" and was read by Smith before it was released.

The 33-page booklet, called "Challenge, Change and Achievement: The Department of Justice 1981-1985," includes a preface by Smith that described achievements in eight areas. It is dressed up by photographs, charts, and a list of the Department's "principal officers." DeCair said the report cost several thousand dollars.

The purported FBI-DEA merger is described in a section on "Targeting the Drug Trade."

"Prior to 1982," Smith said, "the No. 1 Federal law enforcement agency—the FBI—was not being used against the Nation's No. 1 law enforcement problem: narcotics trafficking. For the first time the FBI was enlisted in the antinarcotics battle * * *. At the same time, the Drug Enforcement Administration was formally merged with the FBI, producing a truly unified Federal investigative effort."

The explanation is accompanied by a photograph over the caption, "Then-associate Attorney General Rudolph Giuliani, FBI Director William Webster, and DEA Administrator Francis Mullen look on as the Attorney General announces the merger of the DEA into the FBI."

In fact, there was a news conference about the FBI–DEA relationship. In fact, all the people in the photograph attended it. But what was said at that conference—and what was meant—is in dispute.

An FBI news release from 1982 refers to a "merging and planning of resources" between the two agencies and added, "The FBI is not to become a DEA. The DEA will continue to be the lead organization in the Federal Government's efforts to direct the assault on drug traffickers * * *

The FBI's Bonner said a "merging of resources" is different from a merger of organizations. So does DEA's Feldcamp.

But Justice's DeCair said that a merger of resources is, by any other name, a merger and that in "a few years" agents from both organizations may find themselves wearing the same badge.

DeCair also pointed out that, as of 1982, DEA's Mullen reports to Smith through the FBI's Webster. Before 1982, Mullen and Webster reported separately to Smith.

Feldcamp, for his part, buttressed his argument that the two are separate by pointing out that the DEA has its own budget and that new DEA and FBI agents attend different training academies.

"That [merger] would be a tremendous setback for narcotics enforcement," one DEA agent said. "We deal with the scum of the world. [The FBI is] geared to white-collar crime enforcement, foreign intelligence. They didn't tell me about any merger."

Another added, "Hopefully that [a merger] will never happen. We have a certain amount of pride. They [FBI agents] go to our school for 2 weeks and all of a sudden they're experts."

DEA FEASIBILITY STUDY

Senator MATTINGLY. Do you have any further information?

Mr. WALKER. Well, the information that I have, Senator, right now is that DEA recently completed a feasibility study to address certain options for their training activities, and the options included first, the utility of DEA's training remaining at Glynco.

Second, the transfer of these activities from Glynco to the FBI Academy at Quantico, VA, and, third, the development of a new site and possibly being colocated with DEA's headquarters.

Treasury did not participate in the study. It was a Justice study. We have not actually seen the report. But based on information we have received second hand, we have been told that the study group's recommendations would be to relocate their training to Quantico, where the FBI is located.

However, I spoke yesterday to an associate attorney general, and no recommendation or report had arrived at his desk. I have not been told that even DEA senior management has approved this report at this time.

If this were to occur, I would believe that the rationale would be that DEA is going through a process now of developing closer ties with the FBI. As you know, early in this administration, the administrator of DEA was placed under the director of the FBI, and with the FBI taking up drug jurisdiction, one could see a rationale for combining the FBI and DEA training. Without commenting on whether or not I would make that decision, one can see a rationale for it.

Senator MATTINGLY. I understand the turf problems between Treasury and the FBI and DEA. I understand those. In your testimony, you referred to the fact that the Center was developed because it was decided that it would foster interagency cooperation.

In your testimony you referred to the fact that the Center has met all chalienges and has been quite effective. I would oppose any changes just to shift some organizational blocks around, we don't want to see that happen.

I know Judge Webster appeared before the House Appropriations Committee yesterday, and I believe he said that DEA was sending its recommendations to him today. So, hopefully, we will have further information on that soon.

With that, Mr. Chairman, I would just say I appreciate the opportunity to see my friends again. I just wish I were down in Georgia.

Senator ABDNOR. Thank you, Senator.

REIMBURSABLE TRAINING

Now, just to follow up on the subject which Senator Mattingly was talking about, operating with less dollars, that will be picked up by charging greater amounts to those who do use your facility. You couldn't do that with the other participating agencies, could you? You have so many agencies. How many are there, 59?

Mr. WALKER. Fifty-nine participating agencies, Senator. The basic training is divided between Treasury appropriated funds on the one hand and agency contributed reimbursements on the other.

Senator ABDNOR. Those agencies are all taking 5-percent cuts in their budgets, too, and I wonder if they will be in the position to pay the extra dollars.

Mr. WALKER. If they want the training, they would have to come up with the money. One thing we can state certainly is that there is no free training here, just as there is no free lunch.

Senator ABDNOR. The total budget is in excess of $20 million. Over one-third of that total is reimbursable. Has any consideration ever been given to creation of a unified budget while doing away with the reimbursable program?

Mr. WALKER. Yes, Mr. Chairman; the issue of the extent to which programs should be reimbursable or not is a constant issue that is faced in every budget hearing that I have ever attended, whether it be at the departmental level or the OMB level, or in the course of coming up to the Congress, both on the House and Senate sides.

So it is thought about and considered constantly. There are competing positions that exist with regard to this issue. On one side of the equation the people who would argue for more reimbursement would argue that the agency should have some direct stake in the training programs that occur at the Center, and, therefore, to the extent that they are putting up some money they would have a greater interest in seeing that the training is up to the levels that they want.

On the other side of the equation, there is a feeling that if the Center is not funded from a central Treasury funding source, there will be a fragmentation at the Center, that agencies will seek to go their own ways, and that there will be an erosion of the concept of a centralized quality training facility that was the underlying purpose behind the establishment of this training center.

So there are these tensions that exist, and there is no consensus on how this should happen. I think there are competing viewpoints. Perhaps the Director would like to comment on this.

Mr. RINKEVICH. If I could, Mr. Chairman, the Center's founding fathers originally conceived that there would be one consolidated budget to fund all training activity for all Federal law enforcement agencies that participated in the Center program, and indeed in the early years of the Center up through fiscal 1981, that was basically the funding posture of the Training Center.

It has been since that time, however, that the items Mr. Walker referred to developed to such an extent that there has been an erosion of full funding for the Center and an increase in contributions by the agencies.

It seems to me that concept is inconsistent with the economies of scale that are created by the Center. In fact, it is interesting to note that the cost savings are not realized. A lot of training has to be provided. It is just a question of where the appropriation is made, to the Center, or to the agencies. We are not talking about reducing training here, but the appropriations request.

Senator ABDNOR. I see I opened up a big subject with that question. I will drop it for now.

IMPACT OF A DEA MOVE

Let me ask you, and it was touched on by Senator Mattingly, what is the possibility that DEA may consider moving its Training Program. Is it because they are dissatisfied, do you think?

Mr. WALKER. Well, we have not been presented formally with any proposal at this time. It is still under review, so it is hard for me to guess what the motives are. I wouldn't want to really do much more than just speculate. I do note that there is this consolidation, if you will, or merger, planned, or at least being talked about, for DEA and the FBI, based upon two facts.

One, the administration of DEA has been placed under the Director of the FBI, and second, the FBI has been given expanded jurisdiction into drug investigations, and so if this should result in a decision coming out of the Justice Department, my guess is that the overriding considerations would be related to the relationship between the two agencies.

Senator ABDNOR. What would the impact be on the Center?

Mr. WALKER. Of course, fewer students would be trained at the Center and the Director can give you that.

Senator ABDNOR. Do you have a waiting list?

Mr. WALKER. If I may point out that the DEA training at this time is fully reimbursable, so from a budgetary impact, which I think is important to this committee, there would be no change in terms of the budgetary requirement of the Center because DEA's training today is fully reimbursable by that agency. But perhaps the Director would like to expand on that.

Mr. RINKEVICH. You would be delighted, Mr. Chairman, in knowing that the first year that the DEA participated in Center training was in 1981. They trained 34 students at that time. The last full year was fiscal year 1984. DEA trained slightly more than 1,000 students in basic categories, their basic students as well as foreign and State and local students. They project 1,634 students for fiscal year 1985.

In further answer to your question, there is a waiting list at the Center. There is training that we are not able to accommodate because of the pressure on us from the agencies who are participating. Any vacancy that would be created by the departure of one agency, we are quite confident, would be quickly filled by the queue that is in line for training that we have not been able to accommodate.

Senator ABDNOR. We have been joined by one of our strongest members of this committee, Senator Proxmire. He is here to say something. Do you have a statement?

TRANSPORTATION COSTS

Senator PROXMIRE. No, Mr. Chairman; I do have one question. This is a fine organization, and I congratulate you on the good work you are doing and also on your ability to cooperate with the Congress and the President on holding down spending.

I do have a question with respect to that, however. Your transportation of things budget more than doubles in fiscal year 1986 from $38,000 to $80,000. Can you explain why transportation more than doubles at a time when your overall budget drops and personnel remains the same?

Mr. RINKEVICH. Bill Kelso, our Assistant Director for Resource Management, is here, and will answer that question.

Mr. KELSO. Yes, Senator; I think the basic reason for that increase is that within the last year there has been a drastic increase through legislation on the costs allowance to transferring employees. The Center is in a mode where we, each year, have to move in a number of new instructors and the old instructors go back to the field, and each of the allowance items, such as provision for reimbursement, for the cost of the sale of the home, for the allowances for storage of household goods, all the elements that relate to moves have increased very substantially.

Senator PROXMIRE. You are talking about transportation of things here, not transportation of persons. Would that relate to the transportation of persons?

Mr. KELSO. Yes, it would.

Senator PROXMIRE. It would. I see.
Senator ABDNOR. We passed that.
Senator PROXMIRE. I know, we did indeed, so we are to blame.
Thank you very much, sir.
Thank you, Mr. Chairman.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Gentlemen, we have a number of other questions to submit to you for answer in writing. We have to move along so that time doesn't get by.

We again commend you on your fine operation down there, and we look forward to seeing you again.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

SATELLITE TRAINING PROGRAM AT MARANA, AZ

Question. I believe the Satellite Program at Marana, AZ, has just completed its first class. How did things go?

Answer. The first basic 10 week class graduated from our Indian Police Academy on March 14, 1985. We graduated 27 students in that class and things went smoothly considering this was our initial effort there. We are really just getting settled and some facilities have yet to come on line. We will be making some program modifications and adjustments in the classes to come, which will be two more this fiscal year.

We have also graduated two Bureau of Indian Affairs advanced classes; one in supervision and the other in jail management. These also went very well. Several more are scheduled during this fiscal year.

Once the facilities are completed, we would expect a fairly consistent demand on them. The National Park Service and the Federal Protection and Safety Service have already conducted classes there and we expect to schedule in several U.S. border patrol advanced and specialized classes during the coming months. All in all, I am pleased by our efforts at this point.

MINOR CONSTRUCTION AND MAINTENANCE

Question. The Center is asking for $2.1 million for ongoing maintenance. Can this money realistically be spent during fiscal year 1986 or would it be more appropriate if it was made no-year funding.

Answer. Due to the time required to develop, design, and award contracts, it would be more appropriate if the $2.1 million for minor construction and maintenance was no-year funding. The no-year funding allows the Center to adjust priorities to support requirements in an expeditious manner without losing funds and/or incurring costly and time-consuming administrative procedures. Also, it allows the Center to spread the construction workload throughout the year, which helps to ensure quality project development.

IMPACT OF FISCAL YEAR 1986 FUNDING REDUCTIONS

Question. The fiscal year 1986 budget is almost $1 million below fiscal year 1985. Where will this reduction be made? What impact will that have on the training operations at the Center? Will it affect State and local training?

Answer. The major impact of the net $841,000 funding reduction in fiscal year 1986 will be a reduction in the amount of basic training that will be funded by the Center.

	Fiscal year 1985	Fiscal year 1986
Appropriated	$18,341,000	$17,500,000
Funded student weeks	12,324	10,452
Funded average resident student population	237	201

The result is that the participating organizations will either have to reimburse the Center for more training or forgo that training.

The funding for State and local training will be reduced $100,000. The impact will be less subsidies provided to State and local students.

Impact of 5-Percent Pay Cut not Approved But no Funding Provided

Question. What further reductions would the Center have to make if the 5-percent pay cut was not approved, but no funding was provided?

Answer. The 5-percent pay cut issue involves a cost of $303,000. The impact on the Center would be an absorption of this cost by a reduction in the funded student weeks of training, which is summarized as follows:

	As submitted	After absorption
Funded basic student weeks	10,452	9,209
Projected basic student weeks	59,943	59,943
Funded basic percent (Percent)	17	15

The impact is that the participating organizations will either have to reimburse the Center for more training or forgo that training.

Cost of Housing Accommodations

Question. The cost per student is just over $23 per day for room and board. I understand that housing is a big problem at the Center. Is more housing necessary? Would this cut the per diem cost even more?

Answer. The Center's current daily cost for room and board for students residing in on-site dormitories is $13.90 per student. The addition of $5.75 per day miscellaneous per diem paid by the employing organization brings the total daily cost to $19.65. The Center currently has housing accommodations for 1,444 students which includes 332 substandard lodging facilities necessitated by the U.S. border patrol buildup this fiscal year. Classroom and dining facilities can accommodate approximately 1,700.

Prior to fiscal year 1983, this capacities imbalance did not present a major problem, as on-site housing was normally available to support the scheduled training. Beginning in fiscal year 1983 the Center's training demands dramatically increased to the level that all available housing was in use and off-Center, commercial housing became necessary. During fiscal year 1984 more than 3,000 students were housed in local commercial facilities, at a cost of about $787,000. Current projections indicate that it will be necessary to house more than 3,500 students in commercial facilities during fiscal year 1985 at an estimated cost of $894,000. There is no indication that this trend will diminish in the future and it would seem to be clear that more on-site housing would be desirable and make sense economically.

If additional student housing was available, the daily cost per student to our participating organizations could be reduced simply because of it being cheaper to house students on-site. The Center's current cost per day to house a student is $6.80, compared to the $12 to $14 per day range currently paid for commercial lodging in the local area. Also, additional student housing would provide a broader base over which to allocate fixed costs associated with the operation of student housing, which would enable further cost reductions through economies of scale.

U.S. Secret Service

STATEMENT OF JOHN R. SIMPSON, DIRECTOR

ACCOMPANIED BY:

JOHN M. WALKER, JR., ASSISTANT SECRETARY FOR ENFORCEMENT AND OPERATIONS, DEPARTMENT OF THE TREASURY
WILLIAM R. BARTON, DEPUTY DIRECTOR
EDWARD J. POLLARD, ASSISTANT DIRECTOR, PROTECTIVE OPERATIONS
STEPHEN E. GARMON, ASSISTANT DIRECTOR, ADMINISTRATION
JOSEPH R. CARLON, ASSISTANT DIRECTOR, PROTECTIVE RESEARCH
EDWARD P. WALSH, DEPUTY ASSISTANT DIRECTOR, PROTECTIVE SERVICE
FRANK PALMER, CHIEF, FINANCIAL MANAGEMENT DIVISION
GARY KOWALCZYK, ACTING DIRECTOR, OFFICE OF PLANNING, BUDGET, AND PROGRAM ANALYSIS, DEPARTMENT OF THE TREASURY

STATEMENT OF JOHN M. WALKER

Senator Abdnor. Our next group is John Simpson of the U.S. Secret Service. Mr. Walker will have a statement first.

Mr. Walker. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, it is a pleasure for me to appear before you in support of the annual appropriation request for the U.S. Secret Service. Appearing with me today are the Director of the Secret Service, John R. Simpson, key Secret Service staff members, and Mr. Gary Kowalczyk, Acting Director of the Department's Office of Planning, Budget, and Program Analysis.

The pending appropriations request for fiscal year 1986 totals $283,805,000, a reduction of $7,544,000 when compared with the proposed authorized level for fiscal year 1985. This decrease reflects nonrecurring costs to the Candidate and Nominee Program, technical security programs, a 5-percent pay reduction in the amount of $6,535,000, and an administrative reduction of $600,000.

This past year, the Secret Service was challenged with a number of major events—the Olympics, the protection of candidates and nominees for the 1984 Presidential election, the Republican and Democratic conventions, and the President's trips to Ireland and the London economic summit. At the same time, the Secret Service was also heavily engaged in the programs for protection of foreign heads of state. During fiscal year 1984, the Service provided security for 155 visits of foreign dignitaries. These visits averaged approximately 5 days in length. The Secret Service performed its protective mission during all these events in an outstanding and highly professional manner.

I commend the personnel of the Secret Service for the outstanding job they have done in meeting the many challenges of the past year.

The protection responsibilities of the Secret Service continue to receive its highest priority. Even though field agents were devoting much of their time to protection activities--conducting advance surveys and augmenting protective details—they were still able to effectively perform their criminal enforcement missions.

During fiscal year 1984, $89.3 million in counterfeit currency was recovered by the Secret Service. This represents a 24-percent increase over the amount recovered in fiscal year 1983. Of this amount, $81.7 million, or 92 percent, was seized before it could be passed on to the American public. The fiscal year 1984 total represents the largest dollar value of counterfeit currency ever seized by the Service. The $7.6 million passed on to the American public represents a 3-percent decrease from fiscal year 1983. A total of 89 counterfeiting plant operations were suppressed, and 1,579 individuals were arrested for counterfeiting violations.

Forgery of Government checks continues to be a significant area. During fiscal year 1984, approximately 115,500 check cases were received for investigation. The Secret Service made 3,862 arrests in check forgery cases.

As we move closer to a checkless society, more check forgery will be supplanted by crimes involving electronic funds transfer. The Secret Service, in exercising its jurisdiction over electronic funds cases involving Government agencies, opened 11,457 electronic funds transfer cases during fiscal year 1984.

The Secret Service regards investigative work as an essential complement to its protective responsibilities, and I strongly agree with this position. Investigative work allows agents to enhance their law enforcement skills, and it keeps them in a better state of preparedness for protective assignments.

Overall, this budget is in furtherance of the President's policies to control Government spending.

Mr. Chairman, this concludes my opening statement. I will now ask Mr. John R. Simpson, the Director of the U.S. Secret Service, to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

Senator ABDNOR. Thank you.

Director Simpson?

PREPARED STATEMENT

Mr. SIMPSON. Mr. Chairman, I have a long statement that I would like to submit for the record, with your permission.

Senator ABDNOR. Without objection, it will be made part of the record.

[The statement follows:]

STATEMENT OF JOHN R. SIMPSON

Mr. Chairman, I am pleased to appear before you and the other members of this Committee to present the annual appropriation request of the United States Secret Service and to report on our activities during the current and past fiscal years.

Introduction of Associates

With me today, Mr. Chairman, is the Deputy Director, Mr. William R. Barton, Mr. Stephen E. Garmon, Assistant Director for Administration, Mr. Edward J. Pollard, Assistant Director for Protective Operations, Mr. Joseph R. Carlon, Assistant Director for Protective Research, Mr. Edward P. Walsh, Deputy Assistant Director for Protective Research, and Mr. Frank Palmer, Chief of our Financial Management Division.

Appropriation Request

The pending appropriation request for Fiscal Year 1986 totals $283,805,000, a reduction of $7,544,000 when compared with the proposed authorized level for Fiscal Year 1985. This decrease reflects non-recurring costs to the Candidate and Nominee and Technical Security Programs, a five percent pay reduction in the amount of $6,535,000, a ten percent reduction in administrative workload of $600,000, and program reductions of $1,955,000. This budget request includes no program increases, and reflects a reduction of $2,695,000 below our Fiscal Year 1985 level of operation.

Fiscal Year 1984 was a demanding, yet successful year in regard to the many activities in which the Secret Service was involved. The Summer Olympics, protection of candidates and nominees for the 1984 Presidential election, the Republican and Democratic Conventions and the President's trips to Ireland and the London Economic Summit were some of the protective highlights of Fiscal Year 1984.

Continued Increase in Activities

The past year has shown a continuing increase in the activities of the Secret Service. During Fiscal Year 1984, we provided security to permanent protectees traveling extensively throughout the United States and abroad, and to foreign leaders visiting the United States. At the same time, the problems of world-wide terrorism required extraordinary measures with respect to the protection of not only our permanent and temporary protectees, but foreign missions as well.

Investigative responsibilities of the Secret Service continued to escalate with the addition of investigation of all cases of electronic funds transfer fraud involving Treasury funds, certain credit and debit card fraud and computer crime investigations added to our other criminal jurisdiction.

Protective Effort

Our protective responsibilities continue to receive our highest priority. In this regard, we are continuously evaluating new equipment and methods to assist us in providing a safe and secure environment to those persons whom we protect.

Our 1984 protective efforts were highlighted by the successful conclusion of a Presidential campaign which resulted in great sacrifices by all of our personnel. Adding to this enormous protective responsibility was the increased mobility of our permanent protectees and the protection of over 150 foreign heads of state or government. Significant demands were also made in connection with the security requirements made necessary by two major political conventions, the 39th meeting of the United Nations General Assembly, the Summer Olympics, the Caribbean Conference and the annual meeting of the International Monetary Fund. The problems associated with world-wide terrorism continued to require extra security measures in all areas of our protective activities.

The past year was also a highly successful year for the Secret Service in terms of our ability to accomplish our protective and investigative mandates. In this regard, I am sure you realize that the backbone of our protective and investigative efforts is the dedicated men and women of the Secret Service who have given so unselfishly of themselves in the furtherance of our mission. I would like the Committee to know that I am tremendously proud of their performance.

In addition, I would like to commend the men and women from the other Treasury Bureaus, the Bureau of Alcohol, Tobacco, and Firearms, the U. S. Customs Service and the Internal Revenue Service for their outstanding assistance during the 1984 Presidential campaign.

Assistance of Other Federal, State, and Local Law Enforcement Agencies

Also, the Secret Service continues to rely heavily, especially during a Presidential campaign year, on the assistance and cooperation of local, State and other Federal law enforcement agencies to provide maximum security for our protectees. Indeed, without this support our protective mission would be severely jeopardized, if not practically impossible, and I would also like to commend them for their unselfish and excellent assistance.

Candidate and Nominee Protection

The program for the protection of major Presidential candidates and nominees commenced on November 10, 1983. During

the past fiscal year protection was afforded at the direction of the Treasury 1/ to seven Presidential candidates, two Presidential and two Vice Presidential Nominees and their spouses covering various periods of time as indicated in the following table.

Presidential Candidates/Nominees and Spouses of Nominees Afforded Secret Service Protection

Protectee	Protection Commenced	Protection Terminated
Candidates		
Reverend Jessie Jackson	Nov. 10, 1983	July 22, 1984
Senator John Glenn	Jan. 14, 1984	Mar. 16, 1984
Senator Earnest Hollings	Jan. 14, 1984	Mar. 01, 1984
Mr. George McGovern	Jan. 14, 1984	Jan. 24, 1984
Protection Reinstated	Mar. 05, 1984	Mar. 14, 1984
Mr. Walter Mondale	Jan. 16, 1984	July 18, 1984
Mr. Reubin Askew	Jan. 16, 1984	Mar. 01, 1984
Senator Gary Hart	Jan. 31, 1984	July 22, 1984
Nominees		
Mr. Walter Mondale	July 19, 1984	Nov. 09, 1984
Rep. Geraldine Ferraro	July 16, 1984	Nov. 08, 1984
Spouses		
Mrs. Joan Mondale	July 19, 1984	Nov. 07, 1984
Mr. John Zaccaro	Aug. 21, 1984	Nov. 08, 1984
Other		
Senator Edward Kennedy 2/	Oct. 06, 1984	Nov. 06, 1984

The period July 1, 1984 through September 30, 1984, was a time of especially heavy activity with the protection of candidates and nominees coinciding with the foreign heads of state or government visiting during the 39th General Assembly of the United Nations in New York City, the International Monetary Fund Meeting, and the

1/The Committee that advises the Secretary of the Treasury on Presidential Candidates, as authorized by Public Law 90-331, consists of the Speaker of the House of Representatives, the Minority Leader of the House of Representatives, the Majority Leader of the Senate, the Minority Leader of the Senate, and a fifth person who is chosen by the other four members. The duties of the Committee are advisory in nature. Guidelines establishing criteria for Presidential Candidates are submitted to the Secretary of the Treasury by the Committee. The names of candidates they feel meet and do not meet the criteria set forth in the guidelines are also provided. The final decision is made by the Secretary of the Treasury.

2/Protection was provided to Senator Kennedy pursuant to Presidential Directive.

Caribbean Conference in South Carolina. In addition, the two major political conventions in Dallas and San Francisco required an extensive utilization of manpower and protective efforts.

Summer Olympics

Along these lines, our campaign year grew even more demanding. We provided protection for foreign dignitaries, temporary protectees, and of course the President, at the Summer Olympics in Los Angeles in July and August, right at the peak of campaign activity. In combination with the expansive venue of the Olympic events, in which some sites were as much as 100 miles apart, logistical problems of the greatest magnitude were overcome successfully.

Protection of Foreign Heads of State or Government

At the same time the Service was committed to the protection efforts associated with the Presidential election, we were also heavily engaged in the program for the protection of foreign heads of state or government and Americans on official missions abroad. During Fiscal Year 1984, the Service provided security for 155 visits of foreign dignitaries for an average visit of 4.9 days.

The protection of foreign heads of state or government continues to be an increasingly demanding responsibility of the Secret Service and a significant amount of resources are devoted to this program.

Permanent Protection

During Fiscal Year 1984, the Secret Service provided permanent protection for the President and Mrs. Reagan, and members of their family; Vice President and Mrs. Bush; former President Carter and Mrs. Carter; former Presidents Nixon and Ford and their spouses; former First Lady Johnson, and Treasury Secretary Regan. During

Fiscal Year 1984, these permanent protectees visited 2,094 cities, domestically and 172 foreign cities.

U. S. Secret Service Uniformed Division

The U. S. Secret Service Uniformed Division is charged with the protection of the Executive Mansion and grounds, protection of the New Executive Office Building, protection of the President and members of his immediate family, protection of the official residence of the Vice President, as well as the Vice President and members of his immediate family, and the protection of foreign diplomatic missions located in the metropolitan area of the District of Columbia, and under certain circumstances, foreign missions located outside the metropolitan area of Washington D.C.

During Fiscal Year 1984, the White House Branch Appointments Center cleared over 246,213 appointments. Our Uniformed Division tour detail conducted tours for over 1,058,207 visitors to the White House. In addition to screening all visitors, our magnetometer detail provided security for 161 special White House functions.

Our Foreign Missions Branch provided security coverage for 35 foreign dignitaries while they were in residence at the Blair House or local hotels, covered 224 Embassy receptions and responded to 605 emergency calls. Additionally, our Counter Sniper Program unit covered 1,082 events, the Canine Explosive Detection Program unit performed 77,131 searches and the magnetometer detail conducted 383 screenings. The latter function represents a relatively new role performed by the Uniformed Division. During certain movements of the President, where security considerations warrant it, portable magnetometers accompany the Presidential detail to assist in ensuring the President's security. Our Uniformed Division personnel have been trained to use this equipment and are now a vital part of many protective movements.

I think those who are familiar with the U. S. Secret Service Uniformed Division will agree with me when I say they are without question the finest uniformed force of its kind in the world, and we are immensely proud of their high performance.

Treasury Police Force

The Treasury Police Force, a uniformed branch under the direction of the Secret Service, is charged with the responsibility of protecting life and property at the Main Treasury Building and the Treasury Annex in Washington, D.C., in addition to providing assistance in various protective assignments. This past year, Treasury Police Force personnel arrested 14 individuals, were involved in 12 protective intelligence cases and 26 criminal cases. The Force provided manpower for 228 Presidential security details and 854 escort details. The Treasury Police Force is an integral part of our security arrangement.

Field Offices

During Fiscal Year 1984 and through the Inauguration, the personnel in field offices continued to devote much of their time to protective activities. Special Agents assigned to field offices conducted advance surveys for both permanent and temporary protectees visiting cities throughout the country and augmented the protective details required for visiting foreign dignitaries. Ever-increasing protective requirements will demand the continued use of many investigative personnel in support of our protective mission.

The role of investigative personnel in our protective mission may not be fully recognized. Our investigative personnel continue to spend substantial amounts of time in physical protection activities and those related to protective intelligence. Cases closed in the protective intelligence area totalled 13,538 in

Fiscal Year 1984, up from a total of 12,658 in Fiscal Year 1983. It is hoped that the threat level which ensued following the attempt on the life of President Reagan in 1981 has mitigated slightly with the passage of time. Arrests in this area also decreased slightly from 516 in 1983 to 514 in 1984. Despite a heavy commitment of investigative manpower to protection, the personnel in the field offices maintained a viable level of criminal enforcement during Fiscal Year 1984.

Credit and Debit Card Investigations

The Secret Service initiated credit and debit card investigations as authorized and requested by local United States Attorneys. Over 160 persons were arrested, approximately 3,000 fraudulent credit cards were recovered and approximately $200,000 in equipment which was used to create counterfeit cards and $20,000 in fraudulently purchased merchandise was seized. Collusive merchant "stings", undercover operations and follow-up investigations resulted in a savings to the industry of over $6 million dollars.

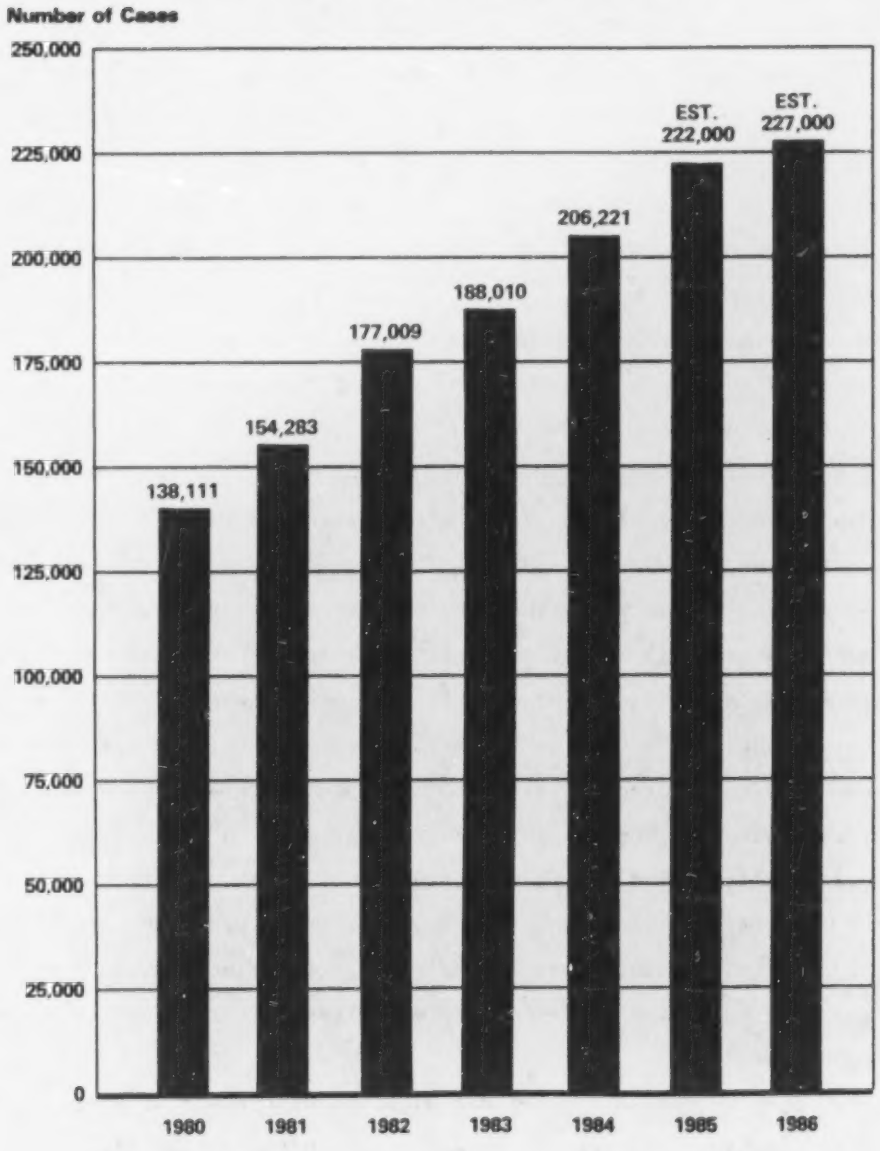
Overall Investigative Caseload

Our criminal investigative caseload continued to increase during Fiscal Year 1984. The 206,000 cases received for investigation represents a 9.6 percent increase over the 188,000 cases received in Fiscal Year 1983. Total figures for Fiscal Year 1984 show a total of 189,000 cases closed, a decrease of 5 percent over the Fiscal Year 1983 level, and 7,100 arrests. The chart on the next page shows the total cases received for investigation over the past five years, as well as the most recent estimates of the number to be received in Fiscal Years 1985 and 1986 (Chart A).

Chart A

Total Cases Received for Investigation

Fiscal Years 1980 - 1986



Counterfeiting Activities

During Fiscal Year 1984, $89.3 million in counterfeit currency was recovered by the U. S. Secret Service. This represents a 24 percent increase over the amount recovered in Fiscal Year 1983. Of this amount, $81.7 million or ninety-two percent was seized before it could be passed on the American public. The Fiscal Year 1984 total represents the largest dollar value of counterfeit currency ever seized by the Service. We are especially proud of this figure since it came about in spite of the demands placed on investigative personnel to augment protective activities during the campaign.

A total of $7.6 million or 8 percent of the counterfeit currency recovered was passed on the American public reflecting a 3 percent decrease in the dollar amount passed over the previous fiscal year. A total of 89 counterfeiting plant operations were suppressed and 1,579 individuals were arrested for counterfeiting violations.

During Fiscal Year 1984, the Secret Service established and coordinated a six month, Title III wiretap operation in New York. It was worked with the cooperation and direct participation in this country of a foreign law enforcement agency. It resulted in the arrest of three individuals in this country and seven in Israel, and the seizure in Israel of $13 million dollars of counterfeit United States currency.

The Far Eastern Counterfeiting Task Force was also established to assist law enforcement authorities in their efforts to suppress the counterfeiting of United States currency in Far Eastern countries.

Negotiations were concluded with the Department of State and authorization was received to re-establish the Milan, Italy Task Force as requested by Italian authorities. The success of the task force in suppressing counterfeiting is an encouraging sign that we have invaluable cooperation from other countries in preserving the integrity of our national currency.

The following charts show for Fiscal Years 1980 through 1984 the dollar value of counterfeit notes seized before circulation, with the overall losses to the public and for Fiscal Years 1980 through 1984 the number and dollar value of the counterfeit notes passed (Charts B and C).

Chart B

Counterfeiting Activity
Fiscal Years 1980 - 1984

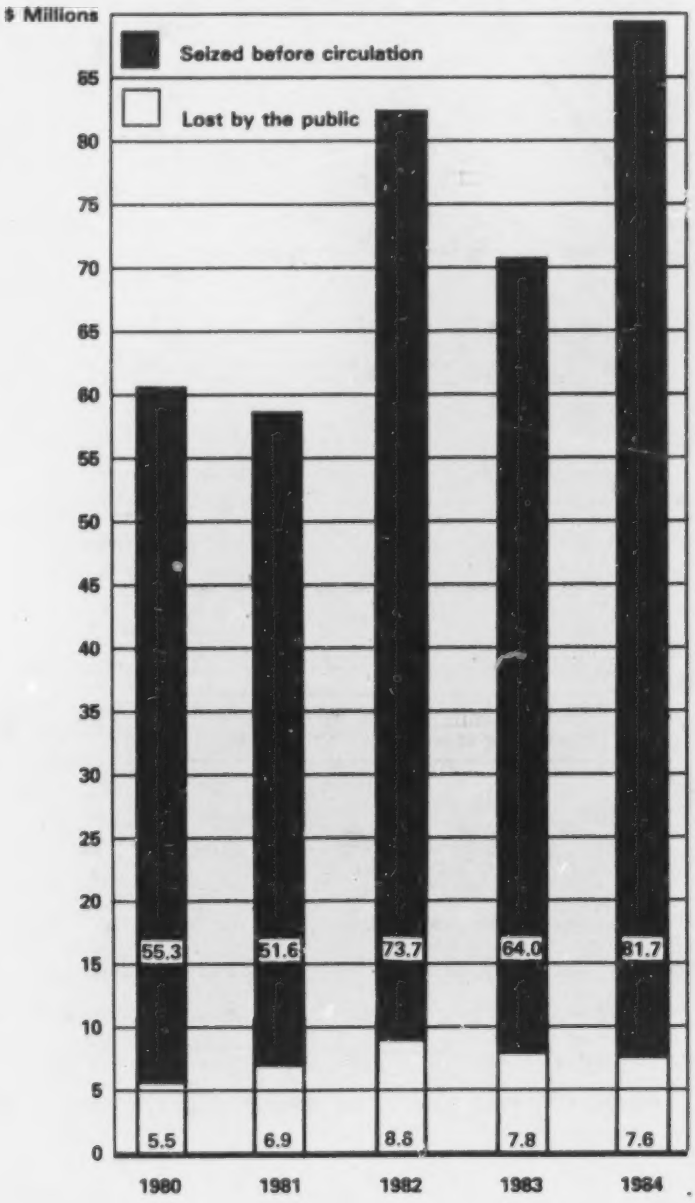
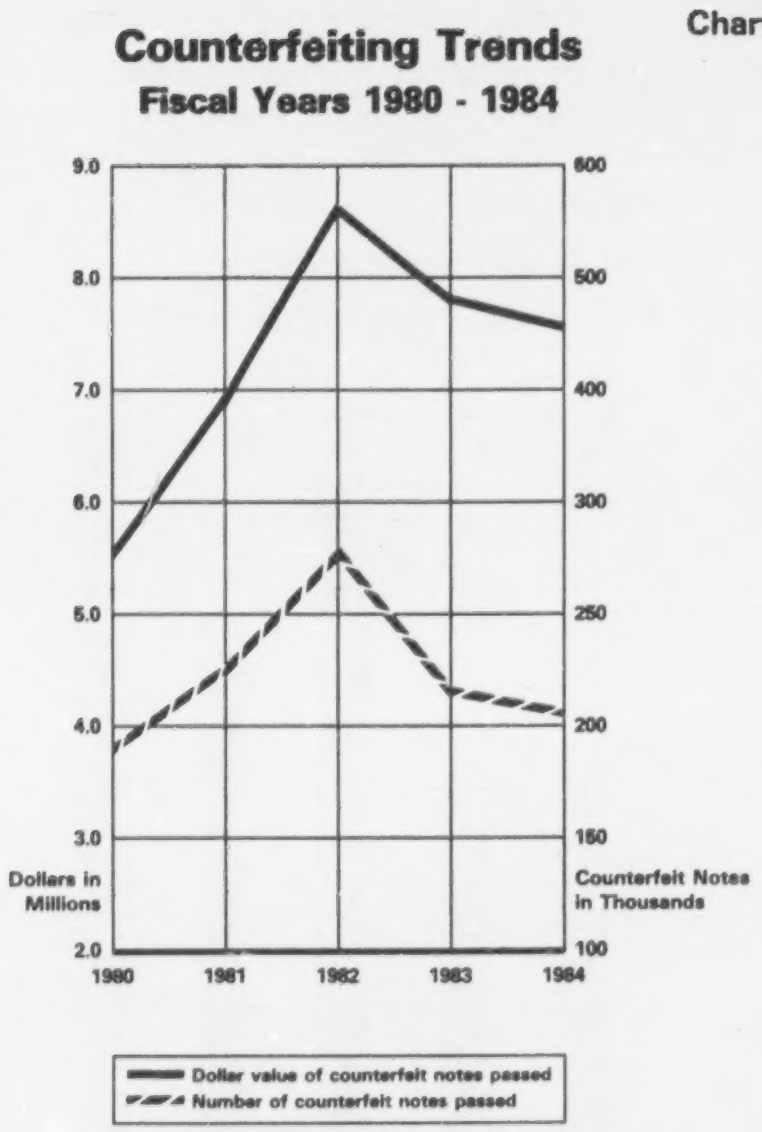


Chart C



Check Forgery

Forgery of Government checks continues to be a significant area of enforcement activity for the Secret Service. During Fiscal Year 1984, approximately 115,500 check cases were received for investigation, an increase of 5,500 cases over Fiscal Year 1983. During the past fiscal year, the Secret Service made 3,862

arrests in check forgery cases, a 19 percent decrease from the Fiscal Year 1983 level of 4,771 arrests.

Each check was analyzed in terms of handwriting and endorsements, and compared with previously received checks. When similarities were noted, they were then "associated" with other check forgers. Through these efforts many of the forged checks were associated with either known or as yet unidentified forgers.

The Secret Service assisted in the passage of Title 18 United States Code 510 which gives us a greatly reinforced forgery statute incorporating felony and misdemeanor penalties. This legislation will close loopholes existing previously in criminal prosecution. The following chart reflects the number of check cases received for investigation for Fiscal Years 1980 through 1984 with estimated numbers to be received in Fiscal Years 1985 and 1986 (Chart D).

Bond Forgery

During Fiscal Year 1984, the total number of bond referral cases decreased from 10,009 cases in Fiscal Year 1983 to 7,003 cases in Fiscal Year 1984. More stolen bonds are being recovered before they are forged, thereby reducing the number of bonds which appear as forgery referrals at a later date. Arrests for the same period decreased from 95 during Fiscal Year 1983 to a total of 61 during Fiscal Year 1984.

The following chart shows the number of bond forgery cases received for investigation during Fiscal Years 1980 through 1984 with the estimated number of cases for Fiscal Years 1985 and 1986 (Chart E).

Fraud

On October 26, 1982 Department of the Treasury Order number 170-1 was signed authorizing the Secret Service to receive and analyze allegations of, and develop information and conduct investigations concerning, thefts and frauds involving any

Chart D

Number of Forged Check Cases Received for Investigation

Fiscal Years 1980 - 1986

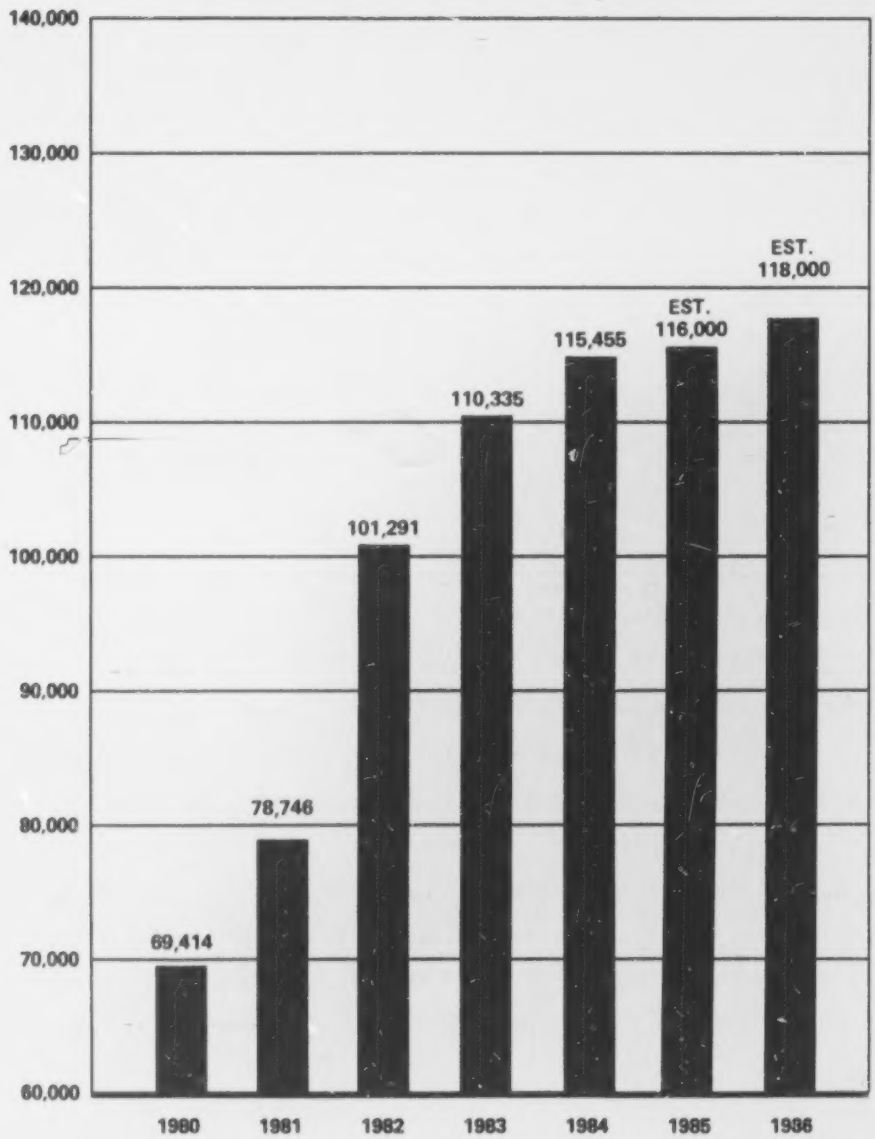
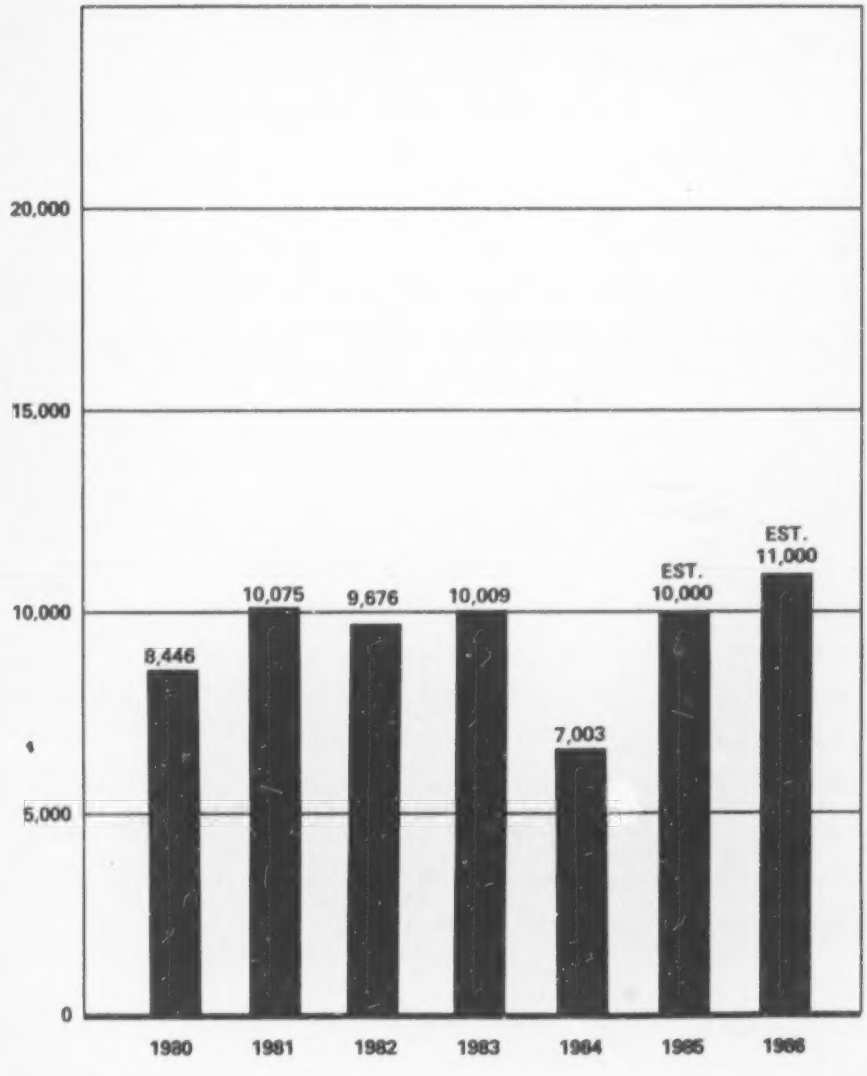


Chart E

Number of Forged Bond Cases Received for Investigation
Fiscal Years 1980 - 1986



electronic transter of funds (a) which belong to the Treasury Department or any subordinate agency; (b) for which the Department or any subordinate agency may be responsible or liable; or (c) with respect to which the Department or any subordinate agency may

otherwise have, or have to defend against, a civil claim of any type.

The dramatic impact of this jurisdiction is reflected in caseload statistics. During Fiscal Year 1984, 11,457 electronic funds transfer cases were received and 7,922 electronic funds transfer cases were closed by our field installations.

Government, public and private sector interest in computer crime is at an all time high. In consequence of this interest, Treasury Bulletin No. 83-84 was issued on September 23, 1983 notifying all government agencies of Secret Service jurisdiction in electronic funds transfer cases. During Fiscal Year 1984, the Secret Service coordinated electronic funds transfer (EFT) fraud detection and prevention programs with federal program agencies as a result of Treasury Bulletin No. 83-84.

This year and in the future, the Secret Service will continue to balance its expanding investigative jurisdiction with its escalating protective responsibility. Our most effective protective agents are those with "street sense" gained from investigative operations. Their instinct and intuition about people and circumstances is sensitized, contributing significantly to their ability to effect a secure environment for protectees. By the same token, investigative assignments allow road weary agents to remain in-district, rotating out of the extraordinary demands of protection related duties. We are gradually regaining a healthy balance between two demanding missions and it is a trend that will benefit us and the public.

Organized Crime

The Secret Service continues to participate in the Organized Crime Strike Force Program of the Department of Justice and is an active member of the National Organized Crime Planning Council, which consists of members of Federal law enforcement agencies. The council visits the several strike forces throughout the

country and gathers information concerning organized crime interests. At present, the Secret Service has designated 14 Organized Crime Strike Force representatives in our field offices who coordinate their efforts with the national representative assigned to headquarters.

Visits by the council to the Strike Force districts have renewed enthusiasm and interest in the program. Our strike force representatives report that inter-agency cooperation has improved and, as a result, information that otherwise would not have been received has become available, proving beneficial to our investigative activities.

Equal Employment Opportunity

The Service has continued to pursue a vigorous program for the recruitment of qualified minority employees, as well as a program to prepare minority clerical employees for advancement into administrative and technical positions. As you know, the Service has a special need for minorities in the ranks of our Special Agents and uniformed officers. Accordingly, we have conducted significant recruitment efforts for these categories of personnel so that we can compete with private industry for qualified minorities. A record number of minority applicants were hired as Special Agents in Fiscal Year 1984. Approximately 22.4 percent of all Special Agents hired were from a minority group.

Extensive efforts were made during Fiscal Year 1984 in cities where we could gain access to designated minority groups. So far we have gained over 740 applications from these recruitment groups and intend to continue in this vitally important endeavor.

Freedom of Information and Privacy Acts

During Fiscal Year 1984, the Service processed 576 Freedom of Information requests and 139 Privacy Act requests. Additionally,

our Chief Counsel processed 81 FOI administrative appeals and actively assisted in the litigation of 16 judicial appeals.

I would like to point out at this time that since the passage of the Freedom of Information and Privacy Acts in 1974, the Service has spent from $200,000 to well in excess of $300,000 each year in responding to tne numerous requests. Of this amount, less than one-half of one percent is potentially recoverable through FOI/Privacy Act billings. Moreover, less than twenty-five percent of this fraction is actually ever received from the individuals involved.

As a result, since 1975, the Service has continually written off uncollectable receivables and continues to bear the financial burden of these acts exclusively.

Protective Research

During Fiscal Year 1984, the White House Visitors Building which houses walk through weapon detectors to screen all persons taking tours of the facility and X-rays to examine their hand carried belongings was completed. Walk through weapon detectors have also been located at other visitor/appointment entrances to the White House/Old Executive Office Building complex to inspect those entering the complex. This included modifying some police booths to provide room for the equipment. The program was performed in cooperation with the Park Service.

Also, the Secret Service in conjunction with Park Service had temporary protective barriers constructed on Pennsylvania Avenue and around the South grounds as well as other security posts. These barriers were constructed to prevent terrorists from crashing the White House fence perimeter.

Training

The accomplishments of our training segment were remarkable during Fiscal Year 1984. In preparation for the rigors of a Campaign/Summer Olympic year, training was conducted and paced so that maximum efficiency and effectiveness of our personnel and those borrowed from our sister Treasury bureaus could be realized. Several candidate details, including supervisors, operations personnel, and shift agents, were trained in preparation.

In addition, 966 agents from other Treasury enforcement bureaus nationwide were prepared to assist us.

Further, military personnel and local police officers from the Convention cities, Dallas and San Francisco, and from the Olympic City of Los Angeles were briefed to insure maximum co-operation. Over 3600 other Federal, state and local police officers and 186 command level law enforcement officials were trained in protective techniques.

James J. Rowley Secret Service Training Center

Continued development of the James J. Rowley Training Facility remains a top priority in terms of the Service's desire to counter threats to our protective mission with the most current training techniques.

We expect to be approximately halfway through our development effort by the end of this fiscal year. Proposed revisions for future development of the Rowley Training Center which reflect changes in our protective training techniques have been submitted to the Treasury Department. We are ready to proceed with the continued development of this facility as soon as Departmental approval is received. Our Fiscal Year 1986 budget request, however does not contain any funding for further development of the Rowley Training Center.

Summary

In summary, Mr. Chairman, the Secret Service has just experienced one of the most demanding periods in its history. The workload and protective responsibilities of the Service continued to expanded and took on new dimensions this past year. In the budget year we are now discussing, it will be quite difficult to maintain this status as our workload continues to increase and available funding decreases.

I am grateful to this Committee for the understanding and support given us over the years. I am equally proud of the performance of the men and women of the Secret Service who have performed so admirably in many difficult situations.

Mr. Chairman, this concludes my statement. I will be pleased to answer any questions you or the other members of the Committee may have.

INTRODUCTION OF ASSOCIATES

Mr. SIMPSON. I have a short statement that I would like to read.

Mr. Chairman, I am pleased to appear before you and the other members of this committee to present the annual appropriation request of the U.S. Secret Service and to report on our activities during the current and past fiscal years.

With me today, Mr. Chairman, is the Deputy Director, Mr. William R. Barton; Mr. Stephen E. Garmon, Assistant Director for Administration; Mr. Edward J. Pollard, Assistant Director for Protective Operations; Mr. Joseph R. Carlon, Assistant Director for Protective Research; Mr. Edward P. Walsh, Deputy Assistant Director for Protective Research; and Mr. Frank Palmer, Chief of our Financial Management Division.

APPROPRIATION REQUEST

The pending appropriation request for fiscal year 1986 totals $283,805,000, a reduction of $7,544,000 when compared with the proposed authorized level of fiscal year 1985.

The past year has shown a continuing increase in the activities of the Secret Service. During fiscal year 1984, we provided security to permanent protectees traveling extensively throughout the United States and abroad, and to foreign leaders visiting the United States. At the same time, the problems of worldwide terrorism required extraordinary measures with respect to the protection of not only our permanent and temporary protectees, but foreign missions as well.

Investigative responsibilities of the Secret Service continued to escalate with the addition of the investigation of all cases of electronic fund transfer fraud involving Treasury funds, certain credit and debit card fraud and computer crime investigations added to our other criminal jurisdiction.

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CANDIDATE AND NOMINEE PROTECTION

The program for the protection of major Presidential candidates and nominees commenced on November 10, 1983. During the past fiscal year protection was afforded at the direction of the Treasury to seven Presidential candidates, two Presidential and two vice Presidential nominees and their spouses.

Along these lines, our campaign year grew even more demanding. We provided protection for foreign dignitaries, temporary protectees, and, of course, the President, at the summer Olympics in Los Angeles in July and August, right at the peak of campaign activity. In combination with the expansive venue of the Olympic events, in which some sites were as much as 100 miles apart, logistical problems of the greatest magnitude were overcome successfully.

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FIELD OFFICES

During fiscal year 1984 and through the inauguration, the personnel in field offices continued to devote much of their time to protective activities. Special agents assigned to field offices conducted advance surveys for both permanent and temporary protectees visiting cities throughout the country and augmented the protective details required for visiting foreign dignitaries. Ever-increasing protective requirements will demand the continued use of many investigative personnel in support of our protective mission.

The role of investigative personnel in our protective mission may not be fully recognized. Our investigative personnel continue to spend substantial amounts of time in physical protection activities and those related to protective intelligence. Cases closed in the protective intelligence area totaled 13,538 in fiscal year 1984, up from a total of 12,658 in fiscal year 1983. It is hoped that the threat level which ensued following the attempt on the life of President Reagan in 1981 has mitigated slightly with the passage of time.

Senator ABDNOR. Why don't we wait until the buzzer stops?

Go ahead.

Mr. SIMPSON. Arrests in this area also decreased slightly from 516 in 1983 to 514 in 1984. Despite a heavy commitment of investigative manpower to protection, the personnel in the field offices maintained a viable level of criminal enforcement during fiscal year 1984.

EQUAL EMPLOYMENT OPPORTUNITY

The Service has continued to pursue a vigorous program for the recruitment of qualified minority employees, as well as a program to prepare minority clerical employees for advancement into administrative and technical positions. As you know, the Service has a special need for minorities in the ranks of our special agents and uniformed officers. Accordingly, we have conducted significant recruitment efforts for these categories of personnel so that we can compete with private industry for qualified minorities. A record number of minority applicants were hired as special agents in fiscal year 1984. Approximately 22.4 percent of all special agents hired were from a minority group.

Extensive efforts were made during fiscal year 1984 in cities where we could gain access to designated minority groups. So far, we have gained over 740 applications from these recruitment groups and intend to continue in this vitally important endeavor.

SUMMARY

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Mr. Chairman, this concludes my statement. I will be pleased to answer any questions you or the other members of the committee may have.

STAFF SUPPORT POSITIONS

Senator ABDNOR. Thank you, John, for that very fine statement. We all concur. You people do amazingly outstanding work with the workload that you have.

I know that the Olympics must have comprised a great deal of work. With the Olympics and the convention, I had trouble getting around myself. I can't imagine how you guard people down there. But you had a very fine year.

As a result, I have noted in some agencies that administrative savings have been made by reducing or failing to fill support staff positions and as a result agents are required to perform clerical duties. Is this happening?

Mr. SIMPSON. We have the lowest support to operational status in the Treasury. We have one support position for seven operating positions.

Senator ABDNOR. You don't have to dip into these people here? I mean the fact that you have been forced to cut back hasn't caused you to have to use other people?

Mr. SIMPSON. We only use operational employees who are on light duty in support capacities. We try to the best of our ability to keep all our employees doing what they do best, be it operational or administrative support personnel.

Senator ABDNOR. It hasn't become counterproductive, has it?

Mr. SIMPSON. Not really, Mr. Chairman. It is not something we would advocate. We would rather have operational people in an operational area.

INITIATIVE ON REDUCING HIGH LEVEL GRADES IN GOVERNMENT

Senator ABDNOR. Has this GS–11 to GS–15 initiative been applied to the Secret Service?

Mr. SIMPSON. It has been applied across the board to all Federal agencies. We take strong exception to people issuing mandates across the board. I am not suggesting that they shouldn't look at it, and I am

not suggesting that some agencies should not be handled that way, but a law enforcement agency builds a reputation and builds what we consider to be esprit de corps by advocating career enhancement. If you suddenly come up with something that will restrict their ability to be promoted, I think that is counterproductive.

Senator ABDNOR. We are concerned about that, and we have been more or less assured that this will not happen.

Mr. SIMPSON. Mr. Chairman, I know that you and the committee in the House have spoken to Mr. Devine and OPM about this.

NEW INVESTIGATIVE RESPONSIBILITIES

Senator ABDNOR. Keep us informed.

With the amendment of title 18 of the United States Code in October 1984, and the passage of the Comprehensive Crime Control Act of 1984, what new investigative responsibilities have you incurred and what progress has been made to define the jurisdictional responsibility in these areas with other agencies?

Mr. SIMPSON. We assumed several, Mr. Chairman. We now have concurrent jurisdiction with the FBI in the area of electronic fund transfers, credit and debit card investigations, and the responsibility for false identification. We are presently working with the FBI on a memorandum of understanding on the issue of jurisdiction. Hopefully over the next several weeks we will have it finalized and everybody will know what their particular area of responsibility is. This way we will be able to handle the new responsibilities in a way that is not counterproductive.

DEFICIT REDUCTION ACT OF 1984

Senator ABDNOR. I am glad to hear that.

The Secret Service is taking an $894,000 travel reduction as a result of the Deficit Reduction Act. In the past that means travel has been included in your request for emergency supplemental funding. Will you be able to absorb a reduction of this magnitude in travel funds in fiscal year 1986?

Mr. SIMPSON. That is a good question, Mr. Chairman, because I don't know what kind of travel problems we are going to have. As you know, we have always included in our supplemental requests additional funds for travel and transportation of persons. It is very difficult for us to guess how many foreign dignitaries will be visiting the United States, whether there will be a summit conference in this fiscal year or the next fiscal year, whether the President or Vice President or any of our protectees will take on a travel schedule that is far in excess of what they are currently traveling.

It is very difficult to come up with a real, concrete guess as to what kind of travel funds we are going to require.

We have, I think, Mr. Chairman, budgeted wisely in the last several years, and this committee, Senator DeConcini and others have been very understanding of what we needed in travel money, and have dealt with us accordingly.

Taking a cut like this, goes back to the age-old problem, you can't put one suit size on every agency and expect it to fit. I believe our agency is one that fits into that area.

PROGRAM REDUCTIONS

Senator ABDNOR. I think that is a good point.

The Service's fiscal year 1986 request includes program reductions of $1,955,000. Can you absorb it?

Mr. SIMPSON. I heard Mr. Rinkevich say he was very much in line with the reduction in the national deficit, as we are, and I am sure that Mr. Higgins would agree, as would everybody else. It is difficult to say yes or no to that type of question because we don't know what is going to be coming down the pike. In all candor, Mr. Chairman, we will do the very best we can. It is something we might find hard to swallow. We are going to have to defer some purchases and some equipment that necessarily must be purchased. They will have to be deferred to other years.

Senator ABDNOR. You are telling me that it could very well be that these reductions certainly affect overall operations of the Secret Service?

Mr. SIMPSON. Yes, sir; it might just do that.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Gentleman, I have other questions that I am going to submit in writing. I want to turn to the BATF here.

Thank you for coming here today.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Additional Committee Questions

COUNTERFEIT CURRENCY

Senator Abdnor: Does the counterfeit currency intercepted by the Service before it gets into circulation include "bad currency" that is passed overseas?

Mr. Simpson: The $81,732,232 in counterfeit currency seized before circulation in Fiscal Year 1984 represents only seizures made in the United States. Separate statistics are maintained by this Service for seizures reported by foreign law enforcement agencies. Although the vast majority of the foreign seizures were confirmed by agents of this Service, it was not always possible to have every individual seizure verified. Furthermore, it is likely that there have been significant seizures made in foreign countries especially in the Middle East, South America and Italy that were not reported to this Service.

Last year, $76,393,100 worth of counterfeit U.S. currency was reported seized by foreign law enforcement officials. About $36,263,100 (47%) was reported seized in Europe, Africa and the Middle East. Another $39,880,000 (52%) was reported seized in the South American countries and $250,000 (1%) was seized in the Far East. We believe a substantial portion of the $250,000 seized in the Far East could have been circulated in the United States through the various commercial and banking avenues.

Since most foreign law enforcement agencies do not routinely report successful passes of counterfeit U.S. currency, it is virtually impossible to estimate how many counterfeit U.S. dollars are successfully passed abroad.

Senator Abdnor: What is the situation today?

Mr. Simpson: During recent years, there has been a dramatic increase in the amount of United States currency counterfeited and circulated throughout the world. In fact, the United States currency is by far the most counterfeited currency in the world today.

It is estimated that in Fiscal Year 1984, 26% of all counterfeit notes passed in the United States were manufactured in a foreign country. In round figures the foreign origin counterfeit currency circulated in the U.S. is broken down as follows:

		AMOUNT	# OF NOTES
Colombia	(14.8%)	$1,117,505	16,459
Asia	(7.0%)	$ 548,200	6,185
Italy	(4.3%)	$ 322,140	4,645

The problems first began in 1963 when eight counterfeit $10 bills were received by our New York Office. It reached an all-time high in 1979 when 20% of the dollar value of all counterfeit currency was attributed to Colombia. Since 1963, 195 different and distinct types of counterfeit notes which are grouped into five major families have been catalogued.

Today, the Colombian counterfeiter continues to prosper. In Fiscal Year 1984, notes originating in Colombia accounted for 14.8% of the total dollar value of counterfeit notes passed in the United States, a loss of $1,117,505 to U.S. taxpayers.

The Far East area continues to supply world economies with the most technically sophisticated counterfeit $100 Federal

Reserve Note ever encountered. This particular counterfeit note is presently the most threatening to the credibility of our currency.

Since January, 1984, the Secret Service has been involved in an extremely difficult and sensitive investigation of these counterfeit $100 Federal Reserve Notes, which were manufactured and distributed in the Far East (Hong Kong, Singapore) and which eventually found their way into circulation in the United States.

It quickly became evident that the Secret Service needed to take extreme steps to combat this counterfeiting ring, through an active "on location" presence with foreign police authorities who are conducting the various counterfeiting investigations. The Secret Service closely monitors and assists these foreign police authorities, lending our expertise and providing whatever support (forensic examinations, investigative techniques) is required to obtain successful conclusions to the cases.

To date, this particular "family" of notes has over one thousand variations. These notes are printed by the intaglio and typographic processes on high rag-content paper with simulated security fibers and are very deceptive notes.

Passing activity in the United States has increased this year with $473,440 in these notes being passed on the public, mainly on the West Coast, with some notes appearing in Miami and New York.

In Fiscal Year 1984, 4,645 counterfeits of Italian origin were successfully passed in the United States. These represented 2% of the total number of notes passed in the United States, with a corresponding dollar value of $322,140. The dollar value represents 4% of the total value of counterfeited notes passed in the United States.

However, the Italian origin note accounts for the overwhelming majority of the $36,263,100 in seizures reported in Europe, Africa and the Middle East.

Senator Abdnor: Would you say Italy is the central point of activity?

Mr. Simpson: Yes. Reports from INTERPOL Headquarters in St. Cloud, France, indicate that a majority of the suspects arrested for possession and distribution of counterfeit U.S. currency in Europe are either Italians associated with suspects in Milan, Italy, or other Europeans distributing counterfeit notes associated with currency believed manufactured in the Milan area.

Guardia de Finanza (Italian Treasury Police) and INTERPOL Rome have also stated that the most prolific counterfeiting operations are centered in and around Milan, Italy.

Senator Abdnor: What is the status of your activity there?

Mr. Simpson: In 1982, our Paris Office received numerous requests from Italian authorities for assistance and support in their investigations of counterfeiters of U.S. currency. However, Paris does not have the resources to maintain a constant presence in Italy.

A working group of agents, a "task force", was dispatched to Italy on temporary duty to assist the local authorities in these investigations.

From July 1982 through April 1983, the task force assisted, supported and monitored investigations with the Italian authorities which resulted in seizures totalling over $5 million in counterfeit U.S. currency and the arrests of 90 individuals.

The task force ended and the Counterfeit Division in Washington, D.C. maintained liaison with the various law enforcement authorities.

In July and October, 1984, the Italian authorities reported two separate investigations which resulted in seizures of counterfeit U.S. currency of $1.1 million and $2.1 million respectively in the Milan area.

Additionally, this Service was notified that there were currently three separate counterfeiting plants active in Milan and wiretaps were being monitored on these locations. The Italian authorities requested that the Milan Task Force be reinstituted in order to assist them in these investigations.

The first task force group was sent to Milan on January 6, 1985, and replacement teams are sent every twenty-one days. These teams consist of five Special Agents, of which two are fluent Italian speakers.

Since January 6, 1985, the Milan Task Force has recorded two plant seizures, approximately $2.7 million in counterfeit $100 Federal Reserve Notes seized, and twenty persons arrested.

Unlike the task force of 1982, where assistance was obtained through the Milan Consulate, all logistical needs for the current task force are being provided by the Secret Service.

ADDITIONAL PERSONNEL

Senator Abdnor: Are the personnel requested in Fiscal Year 1986 sufficient to adequately carry out your mission?

Mr. Simpson: I feel that the personnel requested will be adequate. However, as I have discussed with the committee in the past, with the newly assigned responsibilities of investigating credit and debit card fraud, electronic fund transfer fraud, computer fraud, and false identification documents and devices, we may eventually need additional personnel.

We are currently assimilating these additional responsibilities into our other investigative work load until we can determine precisely what impact they will have. Once this is determined, we may request your assistance in obtaining additional personnel, if necessary.

CONSOLIDATION OF OFFICES

Senator Abdnor: Does the Service have any plans to consolidate the number of offices in order to promote management and administrative efficiencies?

Mr. Simpson: Effective February 1, 1985, the Secret Service converted their field office in Scranton, Pennsylvania to a

resident agency. This was done subsequent to an operational assessment which identified improvements in efficiency and effectiveness by converting Scranton to a resident agency responsible to the Philadelphia Field Office. We have no plans to consolidate any of our field installations. The Service does not operate on a regional management concept. Our protective mission, our protective intelligence mission, and for the most part our investigative mission, do not allow selectivity as to where and when we allocate our manpower resources. We must maintain viable programs throughout the United States. A dispersed field network as opposed to a regional field network promotes efficient operations, maximum utilization of resources, and has proven cost effective.

INTELLIGENCE GATHERING ACTIVITY

Senator Abdnor: Productivity, in the area of intelligence gathering has been greatly hampered by a significant reduction of intelligence information obtained from other law enforcement agencies because of the Privacy and Freedom of Information Acts. To compensate for the lack of intelligence information, the number of Special Agents providing security for each protective detail has been substantially increased. If legislation was enacted removing some of the restrictions now placed on the law enforcement community, would additional staffing still be required? If so, why?

Mr. Simpson: As previously testified the hampering of gathering intelligence information by the Privacy and Freedom of Information Acts does affect staffing levels in protection. However, the enactment of legislation for more ready access to intelligence from other agencies would not, in itself, preclude higher staffing levels. Other considerations such as training, exposure of the protectee, and general staff advance practices play a role in our staffing requirements.

COORDINATION OF INVESTIGATION ACTIVITIES WITH OTHER AGENCIES

Senator Abdnor: How does the Service coordinate its activities with the FBI, Postal Inspectors and other Federal enforcement entities when conducting investigations on electronic fund transfer (EFT) cases?

Mr. Simpson: Coordination of investigative activities with other Federal law enforcement entities is basically accomplished through the use of a formal memorandum of understanding (MOU). MOUs are discussed and adopted at the headquarters level and provide specific guidance to the respective field offices concerning primary jurisdictional boundaries. MOUs have been very successful in that they allow the effective utilization of limited investigative manpower through the elimination of conflicts of interest and duplication of effort.

The Secret Service currently has MOUs with the U.S. Postal Inspection Service, U.S. Department of Agriculture and the FBI. Additional MOUs with the FBI concerning credit/debit card and computer fraud investigations are in progress.

ADDITIONAL CRIMINAL JURISDICTION FOR THE SECRET SERVICE

Senator Abdnor: Should the Service be pursuing responsibility for criminal jurisdiction in any other areas?

Mr. Simpson: Yes. We view our initiatives in this area in a somewhat different light. From our perspective, the Secret Service is involved in more than just the pursuit of additional criminal jurisdiction. We are on record with the Department that the future of our enforcement programs is taking shape today. Furthermore, the types of criminal offenses we traditionally enforce are evolving and giving way to more technically sophisticated fraud-related violations which are directed against the computer-based systems from the electronic era. We believe that it is important to recognize that we are at a crossroad and that it is necessary to chart a course that we safeguard the future of our enforcement programs. Because an elite investigative force is the foundation for an elite protective force, it is essential that we do not lose sight of their interrelationship.

Senator Abdnor: Since the primary mission of the Service is protection, wouldn't the expansion of criminal jurisdiction deter the effectiveness of your protective responsibilities?

Mr. Simpson: The Secret Service is on record that additional enforcement responsibilities would in no way detract from our ability to protect the President and others as mandated by law. The two mission areas, investigations and protection, are not mutually exclusive. In fact, the extensive experience of the Secret Service in protective matters has shown that the best protective agent is one who has trained and performed as a criminal investigator. The agent's ability to recognize dangerous situations and persons is enhanced as a result of "street awareness" and contact with the criminal element through enforcement activities.

It is the position of the Secret Service that our investigative force is just as elite as our protective force, because they are one and the same. In addition, virtually all new enforcement responsibilities of the Secret Service represent technological extensions of our present jurisdiction, e.g. electronic funds transfer (EFT) investigations. Concurrent jurisdictions are supportive of both our enforcement and protective programs, and result in maximized use of the resources available to the Service.

Senator Abdnor: Does the Service have anything to gain by involving itself in additional criminal jurisdiction?

Mr. Simpson: If the Secret Service can maintain viable and challenging enforcement programs, it will be able to attract and cultivate a strong base of criminal investigators - a key ingredient and the best means to provide for an elite protective program.

The "street sense" gained by special agents assigned investigative responsibilities is an irreplaceable asset to agents who will eventually work protective assignments. Their instinct

about dangerous individuals and circumstances is sharpened and contributes significantly to their ability to ensure safety for our protectees.

Lastly, the rigors of protection include excessive overtime requirements, travel out-of-district and shift work. To over-extend agents with long assignments to protection would lead to fatigue, stress, health and morale problems, and a potential loss of efficiency. It is the latter consequence that needs to be avoided. It is our feeling that a healthy balance between the investigative and protective programs will lead to a maximum effectiveness in both mission areas.

IMPACT OF PHOTOCOPIER TECHNOLOGY ON COUNTERFEITING

Senator Abdnor: What impact has the advancement in photocopier technology had on your counterfeiting activity?

Mr. Simpson: The special design features and materials used in the production of genuine currency currently serve as a deterrent to the widespread counterfeiting of U.S. currency. Usually bankers and retailers can detect a counterfeit and alert the Service.

However, advancements in technology have contributed significantly to the growth of counterfeiting while at the same time reducing the skills required to create a passable product. Future advances in reprographic technology are expected to further increase the incidents of counterfeiting and completely eliminate any required skills. Counterfeiting will no longer be a crime of expertise but will instead become a crime of opportunity.

A study by Battelle Columbus Laboratories concluded that offset printing will remain the choice of serious counterfeiters through 1992. Until then, there is no reason to suspect that counterfeit currency manufactured by the offset method cannot be held in check by the same enforcement efforts that have proven effective in the past.

The Secret Service feels that color copiers with improved image quality will begin to become commercially available by 1987-1988, and the problem will escalate on into 1992 when Battelle confirms that color copiers will be available to the "casual user" to such an extent that it will pose the most significant threat for crime of opportunity counterfeiting. Traditional enforcement methods may prove ineffective with the development of technologies with little chance for detection.

The situation is of serious concern to the Secret Service. Enforcement efforts directed at the "casual user" counterfeiter have tended to yield marginal results, primarily because of the difficulty in linking a counterfeit to the actual equipment that produced it and ultimately identifying the person who may have had access to that equipment. To keep pace, the Secret Service is constantly improving its in-house ability to analyze counterfeits manufactured by color copiers and advanced imaging systems and attempting to develop the expertise that will make it possible to establish a connective link.

Fortunately, few such counterfeits have appeared to date. However, most experts agree that it is not whether color copier counterfeiting will be a threat to our present currency, but when.

The suggestion by Battelle Laboratories that the introduction of deterrent features into currency will decrease counterfeiting by a factor greater than ten is certainly not without merit. In conjunction with other indicators, it should serve as an incentive to act. Enforcement alone will not suffice in the battle against counterfeiters. The investigative effort must be integrated with improved design deterrents in order to ensure success. Given production lead time and a myriad of related distribution problems, both the decision on currency design and the associated introduction strategy should commence as soon as practicable.

FOREIGN FIELD OFFICES

Senator Abdnor: What is the status of the new offices you plan to open in Bogota, Rome and Hong Kong?

Mr. Simpson: The Continuing Resolution for Fiscal Year 1983 provided that the Departments of the Treasury and State should facilitate the necessary arrangements to establish a permanent liaison office in Bogota, Colombia and, additionally, that the Secret Service "must open new field offices at Rome, Italy and Hong Kong." Hong Kong was later replaced as a choice for a future overseas office. After careful analysis, it was found that Manila, Republic of the Philippines, was a far better site for the Secret Service in terms of cost effectiveness.

Our efforts to make arrangements for opening an office in Rome have been turned down by the U.S. Ambassador there and we have chosen at this point in time, to increase staffing in our Paris office to compensate for this change in plans.

Likewise, the Ambassador in Manila has also rejected our request. Discussions with the State Department in an attempt to resolve the issue proved fruitless.

Establishment of a foreign field office in Bogota is still pending. However, we are less than optimistic about the successful outcome in this effort.

Regardless of the results of these particular endeavors, the establishment of Secret Service offices in certain strategic locations throughout the world will remain a priority long-range objective.

PROTECTION

Senator Abdnor: Does the Secret Service have specific criteria for determining what resources are necessary to provide protection for candidates?

Mr. Simpson: It has always been the policy of the Secret Service to commit the manpower and other resources necessary to provide the maximum degree of protection. Initially, each candidate begins with almost identical protective support. However, as the campaign progresses, threat levels are constantly being analyzed. If they are determined to be significant, the protective resources might have to be substantially intensified.

As a general rule, threat levels increase with the geographic area covered and the length of time any candidate remains in the campaign. Since both of these factors result in greater public visibility, they would tend to increase protective measures.

CANDIDATE AND NOMINEE PROTECTION

Senator Abdnor: Which major protective events in Fiscal Year 1984 required extensive manpower and resources?

Mr. Simpson: The major domestic protective events for Fiscal Year 1984 were the Presidential Campaign, the Olympic Games, the Republican and Democratic Conventions, the Caribbean Conference, the International Monetary Fund Meeting, the United Nations General Assembly 39, the Presidential and Vice Presidential Debates, and the Presidential whistle stop train trip through Ohio. Each of these events required a major commitment of resources and created unique problems for the Service.

Foreign travel by both the President and the Vice President placed additional burdens on the Service. The President had 16 foreign trips in Fiscal Year 1984, including a visit to the DMZ during his visit to Seoul, Korea, in November; a trip to China in April/May; and a trip to Ireland, the United Kingdom, and Normandy, France, in June.

Senator Abdnor: Regarding the number of candidates provided protection, will the 1988 Presidential Campaign be comparable to the 1984 Campaign?

Mr. Simpson: For the 1984 Presidential Campaign the Service provided protection to seven candidates running for the office of President. This number is relatively small because we had an incumbent President seeking a second term. However, this will not be the case for the next campaign. The Service will evaluate and project all resource requirements necessary to provide Candidate/Nominee protection for as many as 20 to 24 details for the 1988 Presidential Campaign.

Senator Abdnor: Could you provide an object class breakdown of candidate and nominee obligations by fiscal year for the campaign just concluded?

Mr. Simpson: During the 1984 Presidential Campaign the Service's estimated obligations by object class are as follows:

	FY 1983	FY 1984	FY 1985
	(dollars in thousands)		
Personnel Compensation (Overtime)	$ 16	$ 4,020	$ 907
Travel & Transportation of Persons	451	12,882	3,138
Transportation of Things	4	121	7
Rent, Communications & Utilities	21	297	184
Printing & Reproduction	--	5	--
Other Services	5	3,373	807
Supplies & Materials	150	113	14
Equipment	$1,875	79	97
	$2,522	$20,890	$5,154

INTEGRATED NETWORK SYSTEM

Senator Abdnor: What is the status of your Integrated Network System?

Mr. Simpson: The Secret Service is in the early stages of the implementation of a nationwide on-line interactive system. Projected for completion by the end of 1987, the system will interconnect approximately eight hundred terminals nationally. The initial network will be required to support three application areas.

The Master Central Index (MCI) System is the largest of the three applications and the prime driving force behind the creation of a national network. It will automate several administrative processes, and permit a wide range of analyses in correlating criminal activities and identifying offenders.

Second, the Secret Service currently operates a teletype message switch network driving 122 terminals and distributed throughout the U.S. and two overseas locations. This network generates 100,000 messages monthly. Electronic mail is the natural migratory path from the current teletype network, utilizing the integrated network developed for the MCI applications.

Third, the office environment, particularly within field offices, probably will require modification as on-line usage of the network applications alters the daily administrative activity. Office automation, both at Headquarters and in the field offices, is a logical offshoot of the MCI application.

In addition to the above applications the Secret Service has received additional jurisdictional authority that could increase our case load and subsequent data transfer requirements by 50 to 100 percent, or more. The Service also has short term surges in activity as the result of an election year or a crisis response. These phenomena must be considered in sizing our communications requirements.

It can easily be seen that the Secret Service is an evolving agency. We realize that the communications network we adopt will greatly influence the Service's ability to expand functionally and take advantage of progressive technologies. We do not want to build our communications framework around hardware or technology that will restrict or prevent the adoption of new applications. We also want to emphasize that although cost is certainly a consideration, our communications/data processing strategy is more value oriented than cost related.

AT&T DIVESTITURE

Senator Abdnor: Will the divestiture of the American Telephone and Telegraph Company have any long run impact on your Integrated Network System, and if so please explain the impact?

Mr. Simpson: The AT&T divestiture will have major impacts on the Integrated Network System implementation. The divestiture has complicated the initial pilot phases by forcing competitive procurements that were not previously required. In the longer run, the divestiture has created many more implementation alternatives than were previously available, making the choice of selection more complicated. The divestiture has created a lot of

speculation about future costs of telecommunication services making the estimation process much more unreliable. Outright purchase of telephone equipment for many field offices, resident agencies, Headquarters offices, protective divisions and communications trip packages are necessitated as a result of the divestiture.

SATELLITE COMMUNICATIONS

Senator Abdnor: Are there any benefits to utilizing a satellite communication link instead of hard wire transmission for implementing the Integrated Network System?

Mr. Simpson: The Secret Service is not predisposed to the use of satellite communications in the Integrated Network System implementation. We do understand, however, that a satellite-based system would provide a state-of-the-art network, with certainty of cost, complete geographic independence, extreme flexibility of use by expandable bandwidth, and greater reliability at high transmission speeds than is available through hard-wired systems.

VOICE PRIVACY PROGRAM

Senator Abdnor: Why must all radio assets for your communications program incorporate National Security Agency Voice Privacy standards?

Mr. Simpson: A differentiation must be made here as to the level of protection required. Full NSA Cryptographic approved security is not required in our voice privacy program. The system is not intended for use in communicating "classified" non-perishable information.

The level of protection that is required, however, is for "sensitive", perishable information only. Even so, it is our desire and in our interest to utilize a NSA approved algorithm in our system to ensure that the design is sound and highly resistant to attack. We eventually expect to obtain keying variables (codes) from NSA on a wide distribution basis. Therefore, we must be in a position to ensure that our equipment warrants the use of their coding material and that we have their support in providing it. Lastly, recent National Security Decision Directives 113 and 145 require privacy protection for all "sensitive" government telecommunications systems and emphasize that the NSA is the cognizant national authority on all matters of Communications Security.

Senator Abdnor: Does the Service intend to include the Uniformed Division, as well as the Special Agent force, in the Voice Privacy System?

Mr. Simpson: Yes. It is our intention to cover the Uniformed Division's White House and Foreign Missions Branches, Office of Training and technical support groups. The same type equipment in the UHF band is used interchangeably between these elements. With the current threat of terrorist activities, the protective effort relative to the White House Complex and foreign missions is considered sensitive and radio communications should

be protected. Since the Office of Training is involved with teaching the doctrine and conduct of live exercises, their system and operational philosophy should be compatible with all other elements of the Service. Our communications specialists and technical security specialists would also be covered with voice privacy, due to the nature of their work and required communication interoperability with agent protective details and Uniformed Division personnel.

Senator Abdnor: Does the Service have any plans for implementing this system nationwide?

Mr. Simpson: Implementation of the system would begin here in the Washington area with our Washington Field Office which has the responsibility to provide support for our permanent protective details, PPD and VPPD. The Uniformed Division would be next because of its White House protective mission, followed by the Office of Training and the rest of our elements in the Washington area. New York and other large volume protective work load cities would head the list of field offices as the system eventually expands to cover areas outside the Washington area.

Senator Abdnor: Will we have voice privacy for the 1988 Presidential election?

Mr. Simpson: Given a start-up program in Fiscal Year 1985 it was reasonable to assume that the protective side of the system could have been completed, as well as a fair percentage of the field system. This judgment is now modified because additional funding for the continuation of this program was not approved in the Fiscal Year 1986 budget, and because of the uncertainty of subsequent budget increase requests.

BEHAVIORAL RESEARCH

Senator Abdnor: What progress has been made in your behavioral research program?

Mr. Simpson: The need for input by behavioral specialists to the protective intelligence program has been recognized for several years. In its management review following the 1981 attempt on President Reagan, Treasury reflected this need and the benefits the Service could derive from behavioral, medical and social sciences.

Work under a contract signed in May of 1981 with the National Academy of Science/Institute of Medicine (NAS/IOM) was completed with the final report, "Research and Training in the Secret Service". It was published in February 1984 and will provide the basis for the Service's behavioral research program for several years to come. The suggestions regarding 1) the conduct of behavioral research within the Secret Service, 2) the improvement of Special Agent training in the area of interviewing techniques and psychological disorders, and 3) the improvement of working relationships with the mental health community, will be used to formulate research strategies and policies for future efforts. These efforts will involve studies contracted for and by the Secret Service as well as in-house studies by our behavioral research professional staff.

A research policy plan with both short and long term research goals has been developed to continue the momentum begun under that contract. This process includes bringing SAICs from various parts of the country to address various recommendations of the NAS/IOM study. In Fiscal Year 1985, the Service is proceeding with changes to the Training Program for Special Agents as it relates to behavioral research. Additional hours of instructions have been added to pertinent protection-related courses and the latest research information will be included in the basic Special Agent school. During Fiscal Year 1986, the Service will continue to solicit and review proposals for further work in the behavioral research area based upon the Service's research policy.

The Behavioral Research Staff will continue to provide the necessary guidance, with emphasis on further improvements in the management of subjects, especially those evaluated as dangerous, and improvements in methodologies which attempt to predict behavior patterns.

EQUIPMENT

Senator Abdnor: Has the Secret Service managed to stay abreast of the state-of-the-art in the technology needed to counter the threat of international terrorism?

Mr. Simpson: The Secret Service continues to monitor state-of-the-art developments in the area of technical security equipment with the intent to have resources to combat the threat of international terrorism.

As I am sure you have observed through media coverage, international terrorist activity has grown in sophistication. At the same time, we recognize the President's goal to exercise fiscal restraint and we have tried to balance this need with our mandate to ensure the safety of our protectees.

Some of our protective support equipment has been in place in excess of ten years and must be repaired with increasing frequency. As funding allows, the Service intends to replace these aged systems with current, state-of-the-art equipment. However, this becomes difficult under the current budget constraints.

JAMES J. ROWLEY SECRET SERVICE TRAINING CENTER

Senator Abdnor: During the Fiscal Year 1984 hearings, you testified on the vitality of continuing the development of your training facility. At that time we agreed with you and approved funding for the project. Is there any reason why funding is not requested for Fiscal Years 1985 and 1986?

Mr. Simpson: As I indicated during Fiscal Year 1984 hearings, our training facility remains a top priority in terms of our intent to remain abreast of training needs essential to a secure environment for our protectees. Our revised master plan for the Beltsville training facility is with the Department.

Senator Abdnor: Your original plans for construction called for a phased-in effort over three to four years. How realistic is it to assume that the majority of this construction can be

accomplished in two years and what operational problems, if any, would result from a more deliberate phased-in approach?

Mr. Simpson: There has never been a "three to four year" time table. The four phased approach was originally adopted because the National Capital Planning Commission asked for a plan which would satisfy the Service's needs for the "next ten years." The project was broken into the four phases simply to more easily define priorities. It was never expected by the Service that required approvals would be on an "all or nothing" basis for each phase. We have abandoned the four phase concept due to misunderstandings which have led to questions such as this one.

While the Service has an essential operational need for all of the training sites, we continue to be prepared to go forward as quickly as approval and budget would allow. It is possible for the majority of the construction to be completed in two years. We believe that our ability to more effectively and realistically train for our operational objectives rests heavily on attaining the proposed facilities.

Senator Abdnor: Would you discuss how the Department of the Treasury views fulfillment of the training needs of the Secret Service, particularly with regard to Rowley Training Center enhancements?

Mr. Simpson: The Department of the Treasury recognizes the essential relationships of training to operational effectiveness within the Secret Service. It is a fact that Secret Service agents will react to situations in the manner in which they train.

Therefore, the Department totally endorses the concept of hands-on, practical applications training currently employed by the Secret Service. The establishment of an additional shift of agents on the Presidential and Vice Presidential details indicates the commitment of the Service to that type of training conducted on a regularly scheduled basis.

The enhancements to the Master Plan for the James J. Rowley Training Center are consistent with the Department's enthusiastic support of the Service's training needs. The James J. Rowley Training Center is the facility for the Secret Service to conduct the full range of protective training necessary for its mission.

The concept employed by the Service is to have a secure place to conduct integrated protective training in a realistic environment. Integrated training is that training which uses all of the various units of the Service normally employed during a movement of the President of the United States.

As stated, training is essential to Secret Service effectiveness and the enhancements of the James J. Rowley Training Center are essential to the accomplishment of that training.

Senator Abdnor: What impact will it have on your protective training program, if the Service is not allowed to expand its training facility?

Mr. Simpson: The agents and officers would continue to receive protective training in less than adequate facilities. It is otherwise impossible to quantify the impact this would have on our training programs, and consequently our protective mission.

The requested expansion of the training facility would assure secured areas where many life like situations could be duplicated which would provide accurate hands on training exercises. The training would employ all facets of protective training for the first time and would enable instructors to evaluate people and procedures from the "Advance" to the "wheels up" departure. Agents and Uniformed Division would work in these exercises together and every area would serve several functions in its day to day use.

The operational protective effort requires the best training available. Should no expansion be allowed in Fiscal Year 1986, the training will continue to be less effective than what the expanded facility would allow.

Senator Abdnor: If funding for this program is approved, can you assure us that the training center will be completed within the next two years?

Mr. Simpson: Yes, Sir. If funding is approved, the training center will be completed within two years.

Senator Abdnor: How much will be required for the continued development of the James J. Rowley Training Center once the Master Plan is approved?

Mr. Simpson: A no-year amount of approximately $18,000,000 would be required.

Senator Abdnor: How has construction at the James J. Rowley Training Center progressed?

Mr. Simpson: Funding for construction at the James J. Rowley Training Center was first approved in a Fiscal Year 1982 supplemental budget request. This funding, $1,518,000, was used to construct a 2.1 mile roadway on the compound to facilitate future planned expansion and for use in Attack on the Principal exercises. Also included in this construction was an Instinctive Firing Range.

Further funding in the amount of $3,154,000 was provided in Fiscal Year 1984. These funds were used to construct additional road surfaces, which included a protective driver training pad, a protective training support building, a K-9 support building, retention pond #1, improved drainage, water and sewage, and associated electrical and telephone work.

The Master Plan for the Beltsville facility is currently being reviewed by the National Capital Planning Commission. Upon their approval it will be sent through Assistant Secretary Walker (Enforcement and Operations) to Secretary Baker for final approval.

TRAINING AT FEDERAL LAW ENFORCEMENT TRAINING CENTER

Senator Abdnor: Why can't the Secret Service accomplish any of its training objectives by using FLETC or other training facilities?

Mr. Simpson: These features will be used in our ongoing training for the Presidential and Vice Presidential protective

division agents. They will be used in training associated with airport advances and "Attack on the Principal" exercises. Since this is ongoing training and is done during the agents' off-shifts, it would not be practical in terms of time or cost to send our agents, limousines, and other equipment to Georgia for training.

There are no other facilities available other than active airports. For security reasons, we do not feel our training should be carried out in view of the public.

MINORITY STATISTICS

Senator Abdnor: What efforts have been made to recruit minority Special Agents and Uniformed Officers?

Mr. Simpson: We have conducted significant recruitment efforts for these categories of personnel so that we can compete with private industry for qualified minorities. A record number of minority applicants were hired as Special Agents in Fiscal Year 1984. Approximately 22.4 percent of all Special Agents hired were from a minority group.

Extensive efforts were made during Fiscal Year 1984 in cities where we could gain access to designated minority groups. So far, we have received over 740 applications from these recruitment groups and intend to continue in this vitally important endeavor.

FRINGE BENEFIT TAXATION

Senator Abdnor: Will the legislation concerning the taxation of fringe benefits, specifically in terms of government vehicle usage, effect the Secret Service?

Mr. Simpson: It has put us in a situation where we are directing some of our personnel to take vehicles home so that they can conduct investigations and interviews while traveling to and from work. If necessary, they can respond to emergencies at protective sites, but then they are charged for using the vehicle. It seems that we are penalizing our employees for conducting government business.

I understand that there are currently bills before both the House and Senate which, if passed, would exempt Public Safety Vehicles from this legislation. I sincerely hope you will support this effort.

Senator Abdnor: Will the legislation to tax fringe benefits significantly increase the work load of the Secret Service?

Mr. Simpson: As testified earlier, its seems to penalize employees for doing what they are directed to do. Maintaining a record of vehicle use on a daily basis and ensuring that the proper amount of money is added to each individual's salary will require a large number of additional manhours. Frankly, I feel that the cost, especially for our agency, will outweigh any additional revenues to the Treasury.

STANDARD LEVEL USERS CHARGE

Senator Abdnor: The Office of Management and Budget has limited the Secret Service's Fiscal Year 1986 SLUC rates to Fiscal Year 1985 cost per square foot levels. Will the Secret Service be able to operate within these limits?

Mr. Simpson: Because of the OMB directive, the Secret Service had to reduce its SLUC budget for Fiscal Year 1986 by $981,000. Approximately one-third of our buildings have been reappraised by GSA, and therefore Fiscal Year 1986 estimates indicate substantial SLUC increases over Fiscal Year 1985 levels. For instance, GSA has estimated annual increases of $1.3 million at 1800 G Street and $400 thousand at 1310 L Street in Fiscal Year 1986 even though space at these sites has not increased. Under OMB's restrictions it will be difficult to absorb these SLUC costs.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

STATEMENT OF STEPHEN E. HIGGINS, DIRECTOR

ACCOMPANIED BY:

JOHN M. WALKER, JR., ASSISTANT SECRETARY FOR ENFORCEMENT AND OPERATIONS, DEPARTMENT OF THE TREASURY
WILLIAM T. DRAKE, ASSOCIATE DIRECTOR, COMPLIANCE OPERATIONS
PHILLIP C. McGUIRE, ASSOCIATE DIRECTOR, LAW ENFORCEMENT
CHESTER C. BRYANT, COMPTROLLER
PAUL R. GENTILLE, FINANCIAL MANAGER
G. GARY KOWALCZYK, ACTING DIRECTOR, OFFICE OF PLANNING, BUDGET AND PROGRAM ANALYSIS

STATEMENT OF JOHN M. WALKER

Senator ABDNOR. Our final witness this morning is Mr. Stephen E. Higgins, Director, Bureau of Alcohol, Tobacco and Firearms.

It is always good to have you back. Again, I will let Mr. Walker lead off.

Mr. WALKER. Mr. Chairman and members of the committee, I am pleased to appear before you today in support of the annual appropriation request of the Bureau of Alcohol, Tobacco and Firearms for fiscal year 1986. With me today are the Director, Stephen E. Higgins, key ATF staff members, and Mr. Gary Kowalczyk, Acting Director of the Department's Office of Planning, Budget and Program Analysis.

We, in the Department of the Treasury, are particularly proud of the dedication and professionalism of the men and women of the Bureau of Alcohol, Tobacco and Firearms. This Bureau has been the subject of media attention recently for its work in solving the abortion clinic bombings. While Director Higgins will go into greater detail, I would like to mention that in just over 2 years, the Bureau has solved an impressive 22 of 32 crimes, and some of those convicted are already serving prison terms as long as 20 years. While the ATF special agents are among America's finest criminal investigators, they are only now being generally recognized for their expertise and dedication as professionals.

We, in the Department of the Treasury, commend everyone at ATF who has contributed to the successful outcome of these cases.

The BATF is a full participating member of the President's organized crime drug enforcement task force, also known as OCDE. Although ATF has no direct statutory jurisdiction over narcotics violations, they do have a unique opportunity to suppress narcotics-related crime through the enforcement of Federal firearms laws. Because of a growing trend among narcotics traffickers to use and traffic in firearms in fur-

therance of their illegal enterprises, ATF has contributed significantly to the organized crime drug enforcement task forces. By the end of fiscal year 1984, ATF agents assigned to the 12 regional task forces had initiated 342 investigations, recommended 210 suspects for prosecution and seized 1,171 firearms. It should be noted that although ATF represented only 5.2 percent of the interagency task force effort, 17 percent of all task forces indictments were for ATF violations.

The Department of Justice, which has the responsibility for coordinating this program, has identified a need to expand the original 12 regional task forces to 13, with Miami being the 13th core city. ATF has requested a supplemental appropriation to fund their participation in this 13th task force city.

During the 1984 Presidential campaign year, ATF detailed special agents to the Secret Service to assist in the protection of candidates. ATF has done this for previous Presidential campaigns, as have other Treasury enforcement bureaus. Through the assistance of Treasury's enforcement bureaus, the Secret Service is relieved of the need to hire additional special agents every 4 years to meet the peak demands of Presidential campaigns. The ATF has done a commendable job in this protective work.

ATF also assisted in security for the 1984 summer Olympic Games, which were centered in Los Angeles, CA. ATF provided bomb and explosive training as well as training to Federally licensed firearms dealers within the greater Los Angeles area in an effort to monitor the importation of illegal weapons.

I want to take this opportunity, Mr. Chairman, to commend ATF and its Director, Steve Higgins, for the very fine job they have done in fulfilling each of their enforcement responsibilities.

In addition to its criminal jurisdiction, ATF is responsible for regulation of the alcohol, tobacco, firearms, and explosives industries and must ensure that all alcohol and tobacco excise taxes are collected. These taxes are estimated to be $9.1 billion in fiscal year 1986. While this is a significant amount, it is less than the corresponding amount for fiscal year 1984 and fiscal year 1985 because of the reduction in cigarette taxes effective October 1, 1985.

ATF has a strong Revenue Protection Program. By selectively evaluating compliance by industry members, they have been able to maintain compliance levels despite declining agency resources and increasing revenue workload. An overall Training Program has been instituted which has increased the audit skills of ATF inspectors. Additionally, an audit staff now conducts selected examinations and serves as a technical resource available for troubleshooting and expert consultation.

ATF's regulatory role also requires ensuring fair trade practices and maintaining high levels of compliance with Federal laws. ATF's regulatory philosophy is to regulate only where needed, and then only to the extent necessary to accomplish the intent of the statutes. While regulation of sensitive industries and products for which the Bureau has responsibility cannot be eliminated entirely, we believe that regulations

and paperwork can be reduced while maintaining an efficient and effective administration of Federal statutes.

Under the innovative leadership of Director Higgins, the Bureau continues to seek ways to improve its productivity and maintain its effectiveness in this period of very scarce resources. During the past year, a number of administration functions have been centralized to achieve resource savings as well as increase uniformity of operations. In addition, the Bureau relied extensively on contractors to provide selected ongoing and one-time services. It is estimated that these efforts, taken together, saved the Bureau in excess of 20 positions. The Bureau is planning to pursue further opportunities for savings in administrative functions in fiscal year 1985 and fiscal year 1986.

The pending appropriations request for the Bureau of Alcohol, Tobacco and Firearms is $169,562,000 and 2,850 staff years. This budget request represents a small decrease from the fiscal year 1985 budget level, with the major decrease occurring in the Law Enforcement Tobacco Program. Public Law 95–575 was enacted on November 2, 1978, to eliminate racketeering in the sale and distribution of cigarettes. Since that time, ATF has provided the leadership, technical expertise, and training which are necessary to enable the States to develop their own contraband cigarette programs. During that same timeframe, ATF has also provided investigative assistance in complex, multijurisdictional tobacco tax frauds. Consequently, the States have developed enforcement capabilities to address the current problem. In fiscal year 1986, it is planned that major responsibility for the program will be transferred to the States, and ATF's presencewill be concentrated on major violations in those geographical areas most affected by State tax increases.

Mr. Chairman, this concludes my opening statement. I will now ask Mr. Stephen Higgins, Director of ATF, to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

Senator ABDNOR. Very good.

Mr. Higgins?

PREPARED STATEMENT

Mr. HIGGINS. Thank you, Mr. Chairman. It is a pleasure to appear before you in support of the fiscal year 1986 budget request for the Bureau of Alcohol, Tobacco and Firearms. At this time, I would like to submit for the record a detailed general statement and then offer some brief introductory remarks.

Senator ABDNOR. Without objection, the entire statement will be introduced into the record.

[The statement follows:]

STATEMENT OF STEPHEN E. HIGGINS

It is a privilege to appear before you in support of the FY 1986 budget request for the Bureau of Alcohol, Tobacco and Firearms.

Accompanying me are my colleagues Mr. William Drake, Associate Director, Compliance Operations; Mr. Phillip McGuire, Associate Director, Law Enforcement; Mr. Chester Bryant, Comptroller; and Mr. Paul Gentille, Financial Manager.

Our FY 1986 budget request is $169,562,000 and 2,850 staffyears, which represents a net decrease of $2,551,000 and 91 staffyears compared to the proposed authorized level for FY 1985. This request includes program reductions and nonrecurring cost savings of $9,084,000 and 91 staffyears, and an increase of $6,533,000 to maintain current levels of operation. These requirements are discussed in more detail in our FY 1986 budget justification and later in this statement.

The proposed authorized level for FY 1985 includes several adjustments to the Continuing Resolution appropriation of $169,271,000 and 2,920 staffyears. Supplemental funding, in the amount of $3,239,000, is being requested for the following items: $1,339,000 to meet our FY 1985 pay increase effective January 1985; and $1,900,000 and 21 staffyears to participate in the 13th Organized Crime Drug Enforcement Task Force (OCDETF) core city of Miami. In addition, a rescission of $397,000 is proposed in accordance with the Deficit Reduction Act of 1984. The total proposed authorized level for FY 1985 is $172,113,000 and 2,941 staffyears.

I would like to take this opportunity to report to you on several management initiatives.

MANAGEMENT EFFICIENCIES

Administrative

During FY 1984, the Bureau implemented a number of initiatives which were designed to increase administrative efficiencies:

°Financial Management Consolidation: Two years ago, ATF studied all of its decentralized support activities. The study arrived at the conclusion that its fiscal activities could be most effectively centralized at Headquarters. Such a centralization would produce efficiencies resulting from increased uniformity of operations and, at the same time, require a lower level of staffing. The financial management activities were consolidated at Headquarters in October 1983. It has been estimated that this effort has saved the Bureau in excess of 20 positions.

°Other Consolidations: In conjunction with this study, ATF determined that efficiencies would also result from centralizing the protective programs function and elements of the personal property management program at Headquarters. This consolidation was effected simultaneously with the centralization of financial activities.

°Seized Property: The task of processing and eventually disposing of the Bureau's seized property has been an administrative function performed at the regional level. In March 1984, this function was centralized at Headquarters and transferred to ATF's Office of Law Enforcement. It is anticipated that future efficiencies will be gained from this reorganization, since agents that seize and safeguard property will be aligned with the staff who process the paperwork.

°Contracting Out: During FY 1984, the Bureau relied extensively on contractors to provide selected ongoing and one-time services. These have included software development, data input services and training support. This contracting out has played an important role in enabling the Bureau to maintain administrative functions at a lower staffing level.

In fiscal years 1985 and 1986, ATF is planning to review and/or implement additional administrative management initiatives as follows:

°Streamlining of Regional Support Activities: In November 1984, the Bureau conducted a study to determine if additional efficiencies could be realized from further streamlining of ATF's regional support activities. The study's recommendations were adopted by the Bureau's Executive Staff in December, and are currently awaiting Departmental approval and your concurrence. Under this proposal, field support activities, organized under the Office of the Comptroller, will be centralized at Headquarters. It is anticipated that related implementation efforts will begin later in FY 1985 and will continue into the following fiscal year. When fully operational, a savings of approximately 15 staffyears will be realized from this initiative.

It should be noted that ATF has maintained a constant effort for effecting productivity gains in all facets of its support functions. As a result, it has realized gains from improvements in processing operations, increased automation, as well as improved and more efficient procedures. The magnitude of these enhancements in field support operations can best be gauged by observing the reduced level of administrative staffing required over the past 3 years. In September 1981, ATF field staffing support required approximately 146 personnel. When all of the streamlining and productivity initiatives have been implemented, the Bureau will realize a net staffing savings of approximately 80 personnel in its administrative activities.

•A-76 Studies: As the result of a previous A-76 study, it was determined that the Bureau's Distribution Center operations should be performed by a private commercial organization. A contract was signed in January 1985, anticipating that work will commence in May. Tasks under this contract will be performed by the handicapped under a set-aside arrangement provided for under the Wagner-Javits-O'Day Act.

During the remainder of FY 1985, ATF is planning to maintain an ambitious schedule of A-76 studies. Current plans provide for the commencement of six studies during this time period. Five of these will involve the Bureau's laboratory, ADP and communications services. The last will assess mail and file activities. It is anticipated that the first five studies will be concluded in FY 1986 and could result in potential private sector contracts during FY 1987. In total, all of the functions which will be studied presently account for an expenditure of approximately 92 staffyears.

Law Enforcement

Because of the Nation's changing violent crime trends and shifts in population centers, the Bureau's efforts have been directed toward making the most efficient use of our resources. This is accomplished by accurately identifying areas of greatest need based on individual local crime assessments and our ability to have an impact on the crimes, then, as funding permits, making a redistribution of resources according to our staffing model. Our recently computerized staffing model uses population and Uniform Crime Report violent crime rates and other data to compute the most effective deployment of agents. Our goal is to continually strive for optimum staffing of all enforcement offices, as funding permits.

In FY 1984, we began use of an automated Law Enforcement Management Information System (LEMIS) to collect more accurate, meaningful data from field agents and vastly reduce the amount of time spent by these agents on completing routine reports. This system is one of the most advanced management data tracking systems in law enforcement, and provides information needed by Bureau management to gauge the success of our functional programs, and to verify the impact of our resource deployment. In FY 1985, we obtained our first data summary reports from LEMIS. In FY 1985 and again in FY 1986, we will continue to refine this system.

Compliance Operations

Administrative streamlining, paperwork reduction, and judicious use of ADP applications, have enabled ATF Compliance functions to operate more effectively, despite increasing workload and tight resource constraints. These initiatives include:

- Conversion to 3-year firearms and explosives licenses.
- Proposed lockbox processing of license fees.
- Approval of alternative closures for distilled spirits, which paved the way for elimination of strip stamps.
- Automation of National Firearms Act and beverage alcohol label approval system files.
- Introduction and upgrading of automated information systems in Headquarters, regional and field offices.

The inspector force in the field is the first line of defense in the key area of revenue protection and the implementing arm in enforcement of the FAA Act and the firearms and explosives provisions governing regulated industry activities. On a recurring basis, we reevaluate the staffing pattern of our field operations in light of changing workload, which leads to a reallocation of authorized inspector staffing among the regions.

Staffing allocations for firearms work are based heavily on support to ATF law enforcement with additional emphasis on OCDETF cities. Alcohol, tobacco and explosives staffing is allocated in accordance with the number of establishments and an assessment of relative risks.

Finally, we continue to upgrade workforce skills. In FY 1984, we completed basic audit techniques training of all inspectors and their first-line supervisors. A new inspector basic training course has been developed and is being utilized to train new inspectors and other new employees who require similar background in the laws, regulations and industry operations. Compliance Operations is also participating in development of a new ATF supervisory training course. In FY 1985 and 1986, we will continue to emphasize audit-related training, focusing on cost accounting and automated systems as they impact on the verification of excise taxes paid.

LEGISLATION CHANGES

The Comprehensive Crime Control Act of 1984 contains the most significant series of changes in the Federal criminal justice system ever enacted at one time. The new Act will affect the manner in which ATF special agents and Federal prosecutors work together in carrying out their respective responsibilities in the criminal justice system. The Justice Department's Law Enforcement Coordinating Committees will become an important part of the implementation of the Act. ATF will participate in these meetings during 1985.

The Deficit Reduction Act of 1984 contained provisions affecting alcohol and tobacco excise taxes which have already begun to have an impact on Compliance Operations. The major impacts will occur in FY 1986. Key provisions of this act are as follows:

- Requires tax payment by electronic funds transfer (EFT) for large taxpayers.
- Increases the tax on distilled spirits effective 10/1/85.
- Imposes a floor stocks tax on all distilled spirits held for sale by wholesalers and retailers on 10/1/85.
- Repeals strip stamp requirements.
- Imposes restrictions on tax treatment of spirits redistilled in Puerto Rico.

The EFT provisions have been implemented successfully, and have resulted in expediting deposits to the General Fund. Other changes are in progress or have preparations under way.

The floor stocks tax on distilled spirits will have the most severe impact, since approximately 300,000 tax returns are anticipated. We are working with IRS on their handling of receipt and deposit functions, as well as creation of a database for purposes of post-verification. Reimbursements to IRS and costs of field examinations will be absorbed by ATF.

Now I would like to report to you on the Bureau's Law Enforcement and Compliance Operations activities.

LAW ENFORCEMENT

Law Enforcement (LE) activities consist of investigating violations of Federal criminal statutes relating to explosives,

arson, firearms, alcohol, and cigarette smuggling. Bombings, attempted bombings, arsons, and explosives thefts receive our highest investigative priority because of the potential for loss of human life. Intimidation by threat of use of explosives causes public fear and unrest if allowed to go unabated.

Violent criminals, who are a danger to the public because of the criminal misuse of firearms, also receive a high priority considering the great potential for loss of life. Firearms investigations are directed at illegal sources of weapons, as well as criminals who use firearms to commit crimes.

Cigarette smuggling enforcement is focused on high-level multijurisdictional conspiracies involving substantial revenue fraud, where ATF and State or local authorities work as a team. In cooperation with Compliance Operations, investigations of organized crime violations of the Federal Alcohol Administration (FAA) Act are also conducted.

Law Enforcement personnel routinely provide technical investigative assistance, intelligence data, firearms and explosive tracing capabilities, and training to other Federal, State and local law enforcement agencies. Additionally, the Bureau continues to play a major role in the success of the Organized Crime Drug Enforcement Task Force effort.

Explosives Program

The criminal misuse of explosives has become an issue which is graphically depicted in everyday news events. One has only to read the front pages of any national newspaper or watch television news broadcasts to realize that explosives have been used to draw attention to issues promulgated by subversive groups or activist organizations. The resources for constructing an explosive device are readily available to anyone, as well as the illustrative instructions from any number of publications for the manufacture of such a device. Unfortunately, this contributes to the large number of explosives incidents.

Correspondingly, ATF has established the detection, identification, and investigation of explosives incidents as our highest priority. Our basic approach encompasses both reactive and preventive measures, including expeditious responses to bombings or situations involving explosives, and focusing on the arrest and conviction of those responsible for the incident.

Our response to thefts of explosives and the subsequent recoveries of the stolen explosives often abort the potential for bombings. The utilization of computerized intelligence information and data to identify trends or patterns is an invaluable tool to law enforcement in the war on crime. Investigations of unsafe and inadequate storage of explosives further contribute to the protection of persons and property, and reduce the threat of explosives incidents.

As part of ATF's commitment of assistance to State and local law enforcement, an Advanced Explosives Investigative Techniques Course was initiated in 1982. To date, 325 State and local law enforcement officers have been trained at the Federal Law Enforcement Training Center in Glynco, Georgia. The courses, which are the state-of-the-art in post-blast bomb scene investigation, have been so highly acclaimed that they have become a significant part of ATF's explosives program and will also be presented to law enforcement officers of friendly foreign governments as part of the Government's anti-terrorism initiatives. Two additional courses are scheduled for March and September 1985.

During FY 1984, there were 765 bombings or attempted bombing incidents reported to ATF. There were 8 deaths, 152 injuries, and over $6.5 million in property damages associated with these crimes. There were also 221 incidents of reported thefts of explosives. These thefts mean that over 35 tons of stolen explosives entered the illegal market. These figures will probably increase moderately as additional reports are received later this year from other law enforcement agencies reflecting incidents not previously reported to ATF.

In FY 1984, in the explosives program, including arsons,

1,415 investigations were initiated, resulting in 598 defendants being recommended for prosecution. The following explosives cases are examples of significant results achieved in the Bureau's explosives program:

•WASHINGTON, DC: From January 13, 1984 through January 1, 1985, eight bombings and two arson incidents damaged or destroyed ten abortion clinics or pro-choice facilities in Washington, DC, Virginia, Maryland, and Delaware. Included in the targets were the headquarters of the American Civil Liberties Union and the National Abortion Federation.

On January 19, 1985, after one of the most intensive investigations in ATF history, special agents arrested three individuals who have been linked by physical evidence to those incidents. Federal prosecution of those individuals is pending.

•MINNEAPOLIS, MN: On June 8, 1984, a multi-State ATF investigation of the "Gay Strike Force Against Police and Public Oppression," ended with the arrest of Earl Steven Karr at Mason City, Iowa. Karr, the only member of this "group," has been linked to 24 bombings/attempted bombings in Minnesota, Wisconsin, Illinois, and Iowa. Through written communiques left at bomb scenes, Karr had threatened additional bombings in several other Midwestern States. He is presently in custody awaiting trial.

•VERO BEACH, FL: On October 16, 1984, Keith Anderson and Byron Carlisle were indicted by a Federal grand jury in the Southern Judicial District of Florida. The 11-count indictment by the grand jury charged Anderson and Carlisle with the violations of Federal firearms and conspiracy laws. Both subjects were active members of the U.S. Army, Special Forces Unit, Fort Bragg, North Carolina.

This indictment stemmed from a lengthy investigation by ATF involving large undercover purchases of stolen military explosives and equipment from Anderson and Carlisle. This investigation culminated on October 6, 1984, in Vero Beach, Florida, when ATF agents seized approximately 4,700 pounds of stolen military explosives and arrested Anderson. Carlisle was subsequently arrested at Fort Bragg, North Carolina.

•DALLAS, TX: On October 24, 1984, Ricardo Lopez was arrested by ATF special agents in Rockwall, Texas. The arrest stemmed from an ATF investigation of Lopez dating back to 1981. During the investigation, ATF agents seized over 18,000 pounds of stolen military ordnance, explosives and ammunition. Eight other individuals have also been charged.

•FARMINGTON, NM: On September 18, 1982, dynamite bombs caused $20,000 in damages to two Farmington, New Mexico, police cars.

On May 19, 1984, information was developed that identified four individuals who were responsible for the bombings. The joint ATF and State/local investigation also linked the same individuals to the theft and subsequent bombing of a Utah State Department of Transportation truck in 1982. The same suspects are also responsible for at least three explosives thefts from Utah uranium mines.

On August 28, 1984, three individuals directly responsible for the police car bombings were named in a five-count indictment

by a Federal grand jury in Albuquerque, New Mexico. A fourth suspect was indicted for misprision of a felony.

*NEW YORK, NY: On September 21, 1984, Thomas Mills and 11 other suspects were arrested at various locations at Staten Island, New York, by ATF and local authorities. Over an 8-month period, an ATF special agent and a New York City police officer purchased 57 time and pipe bombs, 4 sawed-off shotguns, 10 penguns, 7 handguns, and 31 ounces of cocaine, from the suspects. Five additional pipe bombs were seized during the execution of a search warrant.

Arson Enforcement

Arson enforcement is part of ATF's explosives program. Prior to October 12, 1982, ATF's involvement in the investigations of arson incidents was dependent upon the fact that explosives materials as defined in 18 U.S.C. § 844 were used to initiate the fire and subsequent property destruction. Due to a reluctance by some courts to uphold ATF's jurisdiction in arson cases using the aforementioned explosives definition, it was necessary to amend the statute to specifically cover fire as well as explosives. On October 12, 1982, the Anti-Arson Act of 1982 (P.L. 97-298) was enacted, thus closing a loophole that had allowed certain arsonists to escape prosecution.

While arson is basically a State and local enforcement responsibility, the national magnitude of the problem has exceeded the capabilities of any one agency to effectively respond to the full range of arson crimes occurring within its jurisdictional area. ATF, in promoting the Federal role in this critical program, has spearheaded the drive to coordinate enforcement efforts among Federal, State and local sectors. However, the overall effort by ATF is selective in that we actively investigate only a very small percentage of the total arsons committed throughout the country. We are confident that the direction of our investigation activity, along with our assistance to State and local authorities, is compatible with the overall Federal role required to combat the crime of arson.

During FY 1984, ATF initiated 471 arson investigations. Those arson incidents occurring during FY 1984 resulted in 30 deaths, 190 injuries and estimated property damage in excess

of $219 million. A total of 314 defendants were recommended for prosecution in Federal or State courts.

In addition to the apprehension and prosecution of violators, ATF utilizes a procedure to capture the "insurance dollars saved" through ATF's arson investigative efforts. During FY 1984, $43.2 million was "saved" in the sense that in the absence of effective law enforcement efforts, the insurance industry could potentially have been caused to pay out $43.2 million more in arson-related claims, thus creating a greater burden upon the premium-paying general public and the Nation's economy as a whole. It should also be noted that many of these respective dollar amounts will increase as the ongoing investigations are completed.

In FY 1984, ATF continued its assistance to State and local authorities through the services of four National Response Teams, located in the Midwest, Northeast, Southeast, and Western regions of the United States. These teams, in their short 5-year history, have been activated in response to 112 incidents, involving 60 deaths, 322 injuries and property damage in excess of $346 million.

The arson task force concept continues to be one of our most successful strategies in combatting this most difficult crime. In 12 cities, Seattle, San Francisco, Los Angeles, Houston, Chicago, Boston, New York, Philadelphia, Atlanta, Detroit, Newark, and Dallas, the concept is fully operational with the pooling of talent and resources between Federal, State and local agencies. Additionally, the first of two new task force groups to be initiated in FY 1985 was begun in Minneapolis/St. Paul, Minnesota on January 15, 1985. One additional city will be selected and added by the end of the fiscal year, bringing the total arson task forces to 14.

In October 1982, ATF initiated a 2-week State and local training course in advanced arson-for-profit investigations. This unique training, unavailable anywhere else, deals with indepth investigation into arson-for-profit cases beyond the cause and origin determination. To date, over 250 State and local police and fire service personnel have attended this highly acclaimed

course. This training is in such demand that it has become a permanent part of ATF's arson enforcement program.

The following cases are examples of significant results achieved in the Bureau's arson enforcement area:

°New York, NY: Through November 1984, eight of the nine people charged in a series of arsons in New York have been convicted of violations of Federal conspiracy, RICO and mail fraud laws. The defendants were lawyers, real estate brokers and landlords who had purchased, through various partnerships, 37 partially occupied residential properties in Brooklyn, Manhattan and the Bronx. They then obtained a total of $1.8 million in fire insurance policies from various companies and collected $616,000 in fire loss claims, after setting 43 fires in buildings throughout the three burroughs. Forty-four firefighters were injured in the blazes. The case stemmed from an extensive ATF investigation into this arson-for-profit ring which operated in the New York City area from 1976 to December 1980.

°Martinsburg, WV: On November 2, 1984, following a 10-day jury trial in U.S. District Court, a woman was found guilty of four counts of conspiracy, mail fraud and arson. This conviction stemmed from a 2 1/2 year investigation by ATF into the arson of the defendant's business in Berkley, West Virginia. The defendant had hired her two teenage children to burn the business, however, both of the children were killed when the fumes from the 15 gallons of gasoline that they had poured into the building exploded. On December 13, 1984, the woman was sentenced to 15 years in prison for the crimes.

°Seattle, WA: On December 20, 1984, a man was sentenced to serve 20 years in prison as well as restitution in the amount of $295,000. This sentence resulted from his conviction for arson incidents involving four abortion clinics in the State of Washington. The conviction was the result of an 11-month, intensive investigation by ATF and the Everett, Washington, Police Department.

°Miami, FL: On June 4, 1984, arson destroyed a restaurant and lounge in North Miami, Florida, causing $1.2 million in damages. A joint investigation was initiated by ATF and local authorities. The ATF National Response Team was also activated and assisted in the crime scene search. Within a week, four suspects were developed through interviews and physical evidence. By November 1984, all three principal defendants had been sentenced to substantial prison sentences for their roles in this arson-for-profit.

°Boston, MA: On January 3, 1985, the sixth of seven defendants was sentenced to serve 40 years in prison on arson charges stemming from a series of almost 300 fires which plagued the greater Boston area in 1981 and 1982. These fires caused over $30 million in property damages and injuries to 363 people; several of those injured are permanently disabled. This case combined the resources of ATF and local authorities in an intensive 2-year investigation into these arsons. The convicted conspirators have been sentenced to terms in prison ranging from 5 to 40 years. One of those convicted was a Boston police officer. The remaining defendant, who is presently on trial, is a Boston firefighter.

Firearms Enforcement Program

The cornerstone of ATF's firearms enforcement program is our Crime Impact Program (CIP). The first phase of the program is a realistic assessment of local, State and Federal crime problems and their interrelationships through numerous contacts and interviews with other law enforcement and judicial officials at all levels of government. The second phase focuses on those crimes, criminals, or criminal organizations which pose the greatest threat to American society based on a consensus opinion of the criminal justice community.

Our firearms program can be categorized into five major areas. The first is classified as the Dangerous and Special Offenders/ Organizations, focusing on those individuals or groups identified as habitually active and violent criminals. Greater emphasis has been placed on organized crime figures, members of violent extremist groups, outlaw motorcycle gang members, and major narcotics dealers. The following are but a few of our accomplishments in this area:

- On July 24, 1984, a convicted felon and organized crime figure, was indicted and arrested for felony firearms charges in New Orleans. The subject was previously convicted for obstruction of justice and has been arrested for extortion, fraud, and racketeering violations. He is known to be a bodyguard, strong-arm man, and close associate of the Mafia boss of the area, who is currently serving a Federal prison sentence for a racketeering conviction. On September 14, 1984, the subject of this investigation pled guilty.

- On December 2, 1983, ATF undercover special agents bought twenty-five .45 caliber semi-automatic pistols with silencers for $25,000 and subsequently, the same subject agreed to sell 50 unregistered MAC-11 machine guns. A sum of money was "fronted" to the subject who in turn provided the undercover agents with a sample of the machine guns he hoped to produce. The subject then spent the next six months in Europe attempting to consummate an unrelated international arms deal. When it was learned that there was an unassociated ongoing U.S. Customs investigation on the subject, he was immediately arrested upon his return to the United States on December 12, 1984. Adjudication is presently pending.

- On August 16, 1984, a Federal firearms licensee and his associate were arrested by ATF for using fictitious Federal Firearms Licenses to unlawfully purchase in excess of 600 firearms. Many of these firearms have been associated with violent crimes in the Chinatown area of Manhattan.

The second major category of the firearms program concerns criminal trafficking of all types of firearms. This area can be summarized as the identification, investigation, and apprehension of individuals or groups who are substantial sources of firearms for the criminal element, and who demonstrate a flagrant disregard of the law. Included are those who illegally deal in stolen firearms and are involved with burglary and fencing operations and those who illegally traffic, manufacture, or convert machine guns and silencers. The following are some of our accomplishments in this area:

- ATF special agents working undercover developed a series of related investigations involving public figures, police sheriff's officers, and citizens in the Chicago, Illinois and Gary, Indiana, area who were selling firearms without a proper license. The undercover agents purchased over 125 firearms, many stolen from the Gary, Indiana, Police Department and Lake County, Indiana, Sheriff's Office evidence vaults. The weapons included machine guns and silencers, handguns, rifles and shotguns. Some of these firearms, when purchased, still had the Gary or Lake County, Indiana, evidence tags attached. On April 25, 1984, in furtherance of this investigation, ATF special agents executed a search warrant at the Lake County, Indiana, Sheriff's Department in Crown Point, Indiana. Seized as evidence were 74 firearms. A silencer and 11 assorted weapons, seized pursuant to the warrant, were reported stolen from other states. The sheriff has made incriminating statements about these weapons. It is expected that the sheriff will be indicted in early 1985 for firearms violations. All other defendants have been found guilty or have pled guilty.

- On June 6, 1984, ATF conducted simultaneous raids in seven locations in California and Nevada. The raids resulted in 7 arrests and the seizure of approximately 60 machine guns and component parts, 24 silencers, 30 pistols and rifles, and assorted firearms records from a Federal firearms dealer licensed to sell automatic weapons. On June 7, 1984, a Federal search warrant was executed at UPS, Las Vegas, Nevada, on seven packages. The search revealed 31 KG-99 firearms, 49 KG-99 conversion bolts, and component parts for 75 silencers, all of which were seized. These warrants were the result of an investigation into the activities of a Federally licensed automatic weapons dealer and four co-conspirators who were illicitly converting and/or manufacturing machine guns and silencers in two factories in separate cities.

- In March 1984, ATF special agents arrested a Federal firearms licensee and two others in Houston, Texas. They were attempting to trade machine guns and silencers for 1,000 pounds of marijuana. Seven silenced machine guns and several loaded handguns were seized. The licensee agreed to cooperate with ATF and told them where he was to meet a Louisiana Federally licensed automatic weapons dealer and three individuals who had previously and unlawfully purchased automatic weapons from him. This particular sale was to be for 16 machine guns. Three days later the four men arrived; a 1983 Cadillac and $6,325 in cash were seized. In all, a

total of 8 defendants were identified and 90 firearms and silencers were seized.

The third major firearms program area involves the illegal movement of firearms in international traffic, a worldwide concern. Since ATF has the primary responsibility in this country for the enforcement of Federal firearms laws, the Bureau must maintain an aggressive commitment toward neutralizing the illicit movement of firearms into, and out of, the United States. Examples of our efforts in these areas are:

- On July 14, 1984, ATF special agents arrested a resident of Trinidad-Tobago for violations of the Federal firearms laws. Previously, he had entered the U.S. on four occasions for short visits. During these visits, he purchased a total of 54 firearms. Embassy officials state that the islands of Trinidad and Tobago are suffering from an increase in gun-related crimes and narcotics activity. Only recently, with the insurgence of violent crimes, armed robberies, and narcotics traffickers, have law enforcement officials had a need to carry firearms.

- On January 5, 1984, a Miami Federal Grand Jury returned a 75-count indictment against a Federal firearms licensee and two other men. The indictment culminated an investigation concerning over 900 illegal firearms sales made by the licensee. Investigation revealed that the firearms were being diverted to Colombia, Venezuela, Paraguay, and other Central and South American countries. The sales were being concealed by false entries in the firearms transaction records to conceal the identity of the actual purchasers.

The fourth firearms program area, Technical Assistance, involves testing and evaluating firearms, ammunition and implements of war for proper classification under Federal law, and advising State, local and other Federal agencies on the technical aspects of firearms. We also trace firearms to assist Federal, State, and local law enforcement authorities. For example, in FY 1984, ATF received more than 37,000 requests for firearms traces from various law enforcement agencies. Seventy percent (25,998) were successfully completed and the information transmitted to the requestor. Two notable traces are as follows:

- The Reno, Nevada post of duty conducted a firearms trace for the Nevada Division of Investigation on August 28, 1984. The firearm traced was a weapon found at the scene of a suspected homicide where the victim was burned beyond immediate identification. The successful firearms trace led to the identification of the victim and to information that the victim had, in fact, committed suicide.

- On December 28, 1984, the body of a homicide victim was found lodged in the ironwork of a bridge spanning the

Missouri River in Ray County, Missouri. An ATF trace of a firearm found at the scene was traced to an Austin, Texas pawnshop. Examination of dealer records indicated that the victim had signed ATF form 4473 at the time of the purchase. She was accompanied at the time of the transaction by her husband, a multi-convicted felon. The victim's husband has been charged with first degree murder.

The last area involves investigating relief from disability applications. During FY 1984, ATF completed 1,426 of these investigations, restoring the right to 722 qualified applicants, and denying 557 applications.

Alcohol Program

ATF investigates criminal violations of the FAA Act and sections of the Internal Revenue Code. Emphasis is placed on suppressing organized criminal infiltration of the legal liquor industry and deterrence of large-scale manufacturers and distributors of non-taxpaid alcohol where State and local authorities have insufficient jurisdiction. ATF also provides training to State and local officers in illicit liquor investigative techniques.

To ensure fulfillment of our objectives, the Bureau has developed the following strategies to:

- Target industry members for investigation where serious noncompliance with Federal laws and regulations is strongly alleged.
- Conduct FAA Act investigations, based upon significant allegations or intelligence, to ensure the integrity of State officials in control States engaged in the distribution of alcohol beverages.
- Conduct legal alcohol enforcement training courses concentrating on violations of ancillary felony statutes, e.g., RICO, Hobbs Act and mail fraud.

The following are examples of the type of alcohol investigations that have already been conducted by ATF:

- On June 24, 1984, the former president of a major distillery was convicted in Federal court following a lengthy investigation. ATF's investigation revealed that the former president of the corporation, and seven other defendants, violated the Internal Revenue Code and the FAA Act. To date, the defendants have paid $306,000 in interest and penalties. An additional $401,836 in interest and penalties have been assessed the defendants.
- ATF agents have concluded an investigation into significant trade practice violations by a major brewery and its authorized distributors in the Los Angeles area. The brewery was found to be excluding other brands at major sporting events by making illegal payments to concessionaries and sponsors of events at Dodger Stadium, Anaheim Stadium, the Forum and Olympic Stadium.

The alcohol program expends a minimal level of resources to investigate illegal "moonshining" activity. This illicit activity has been significantly reduced by the past efforts of the Bureau. However, as a result of the Deficit Reduction Act, PL 98-369, the distilled spirits excise tax will increase 19 percent from $10.50 to $12.50 a proof gallon in FY 1986. The tax change could trigger an increased incentive to illegally produce non-taxpaid spirits. The program will be closely monitored to determine any effects from the tax change.

Tobacco Program

Public Law 95-575 was enacted on November 2, 1978, to eliminate racketeering in the sale and distribution of cigarettes. Since that time, ATF has provided the leadership, technical expertise and the training which are necessary to enable States to develop their own contraband cigarette programs. During that same time frame, ATF also provided investigative assistance in complex, multijurisdictional tobacco tax frauds. Consequently, the States have developed enforcement capabilities to address the current problem with a reduced presence by ATF. In FY 1986, responsibility for the program will be transferred to the States, and ATF presence will be concentrated on major violations in those geographical areas most affected by State tax increases. A program reduction of 45 staffyears will be realized.

The following is an example of the type of contraband cigarette investigations that ATF was recently involved in:

°ATF agents and West Virginia State Police officers have arrested two suspects in possession of 3,100 cartons of non-taxpaid cigarettes in Charleston, West Virginia. ATF agents observed the suspects purchasing the cigarettes in North Carolina, and followed them to West Virginia. The ensuing investigation resulted in the identification of seven major retail outlets for smuggled cigarettes in Michigan and the execution of seven search warrants in Flint, Michigan by State Treasury agents. An additional 1,893 cartons of smuggled cigarettes, with the North Carolina tax stamp removed, were seized pursuant to the search warrants.

Organized Crime Drug Enforcement Task Forces

On October 14, 1982, President Reagan announced that 12 regional task forces would be created to implement a coordinated Federal effort against drug trafficking and organized crime. The task forces, designated as Organized Crime Drug Enforcement Task Forces, are now fully operational, and are demonstrating impressive results. By the end of FY 1984, ATF agents assigned to the OCDETF had initiated 342 investigations, submitted 146 cases, and recommended the prosecution of 210 OCDETF targets. It should be noted that although ATF represented only 5.2 percent of the entire OCDETF, 17 percent (165) of all OCDETF indictments were for ATF violations.

During FY 1985 and FY 1986, ATF's efforts in the task forces will continue to be directed against violations of the Federal firearms and explosives laws committed by organized criminal groups whose principal income is derived from the trafficking in illegal drugs. Moreover, in FY 1985 the Bureau is requesting resources to support Miami as the 13th OCDETF city by providing additional agents and resources to suppress narcotics-related firearms violations in Southern Florida. Supplemental funding has been requested for this purpose in FY 1985.

The following cases are examples of significant results achieved by the Bureau's OCDETF participation:

- California: This investigation involved an organization comprised of an estimated 200 people residing in the San Diego/Tijuana area actively engaged in the smuggling of marijuana and cocaine into the United States since 1978. The organization was believed to be responsible, on a monthly basis, for distributing drugs with an estimated street value of $10 million.

  Five search warrants executed in June 1984 on suspects in this investigation resulted in the seizure of 4,400 pounds of marijuana and numerous firearms, including assault rifles believed to be intended for smuggling into Mexico. A 46-count indictment, charging 24 defendants, was returned by a grand jury in San Diego.

- Georgia: In late 1983, ATF agents developed information relative to a cocaine operation involving, among others, a North Georgia County sheriff. Following an extensive investigation by DEA and ATF agents, the sheriff was charged with and convicted of a firearms violation and conspiracy to distribute 40 kilos of cocaine. Five other defendants were found guilty of various charges.

°Ohio: ATF agents in Cleveland developed information that the leader of an Ohio cocaine smuggling operation had, over a period of several years, committed a number of arsons and bombings. A task force investigation was initiated, with agents of DEA, FBI, U.S. Customs, ATF, and State and local offices participating. The investigation led to a 25-count indictment, charging six defendants, with ATF, DEA, and U.S. Customs violations. One of the defendants charged in this case was the international cocaine supplier to the organization. He was arrested as he entered the country. Thirteen arsons and bombings have been cleared in this investigation.

Assistance to the United States Secret Service

During the 1984 Presidential campaign year, ATF expended 131 staffyears in protecting candidates. A portion of our commitment to the U.S. Secret Service, 15 staffyears, will carry over to FY 1985. It should be noted that at one time during the campaign, ATF had 370 special agents detailed to Presidential and dignitary protection.

We appreciate the U.S. Secret Service requesting our assistance and we believe this reflects on the professionalism of our field agents and has further reinforced our working relationship with our sister agency.

The 1984 Summer Olympic Games

As a result of a terrorist takeover at the 1972 Olympic Games in Munich, West Germany, security procedures have become an ever-increasing problem for law enforcement authorities at these events.

The 1984 Summer Olympic Games, which were centered in Los Angeles, California, presented unique law enforcement security problems because of the diverse locations of the actual sporting events, the number of heads of state and other international VIPs who visited the Los Angeles area during that period, and the political unrest which exists in many parts of the world today.

Security for the games was the primary responsibility of State and local authorities. The Federal role was one of prevention, support, and bomb and explosive training. ATF also provided training to Federally licensed firearms dealers within the greater Los Angeles area in an effort to monitor the importation of illegal weapons. To that end, ATF redirected 54

special agents and support personnel to Los Angeles for a total of 70 days. Additionally, ATF provided support to the security for events scheduled to be held in Boston, Massachusetts and Annapolis, Maryland. ATF furnished two fully-equipped National Response Teams (NRT) onsite at the Los Angeles Olympic Games, with an additional standby team, having a 24-hour response capability.

ATF representatives participated as active members of four Olympic Law Enforcement Security Planning Subcommittees; the Bomb and Bomb Threats (EOD) Subcommittee, the International Entry Subcommittee, the Dignitary Protection Subcommittee, and the Intelligence Subcommittee.

COMPLIANCE OPERATIONS

ATF's regulatory philosophy is to regulate only where needed, and then only to the extent necessary to accomplish the intent of the statutes. While regulation of sensitive industries and products for which the Bureau has responsibility cannot be eliminated entirely, we believe that regulations and paperwork can be reduced while maintaining an efficient and effective administration of Federal statutes.

One of our objectives is greater selectivity in the utilization of resources so that the Government and the taxpayer will derive the greatest possible net benefit from resources committed to our programs. We try to gear the regulations and our activity directly to the degree of risk or jeopardy. We also match requirements and regulatory oversight to the size of the operation and the scope of the regulated activity.

To concentrate resources in sectors which most require attention, we have established criteria for selection of targets for compliance efforts, and use statistical and narrative data to analyze potential workload.

We also seek to improve compliance levels by the adoption of more effective methods of processing our workload. Several initiatives have been established to improve the productivity

of our offices. For example, we reach numerous industry members simultaneously by conducting Government/industry seminars, meeting in public forums with industry members to work with them to achieve compliance. These meetings help foster greater understanding of the Federal statutory requirements. We also invite State representatives to these seminars so that there may be a clear understanding of Federal and State responsibilities.

Our major programs illustrate our efforts to reduce regulatory intrusion and to optimize benefits.

Alcohol and Tobacco Revenue Protection Programs

Historically, ATF has encouraged the alcohol and tobacco industries to pay the proper taxes through a strong revenue examination program. We believe that the current rate of tax compliance is directly related to this effort and that we can only expect future compliance to be as good as the examination, verification and enforcement process.

By selectively evaluating industry members, we believe we have been able to maintain an acceptable level of compliance despite declining agency resources and increasing revenue workload. Audit skills of inspectors have increased dramatically. A staff of GS-511 auditors was created and now fills a valuable role both in conducting selected examinations (and also arson audits in support of law enforcement) and as a technical resource available for troubleshooting and expert consultation. Current plans call for the Headquarters audit function to become increasingly involved in setting standards for, and reviewing quality of, revenue protection programs.

A changing industry environment presents new challenges for maintaining compliance and preventing revenue loss. For example, delay or default on excise taxes is an option that marginal operators hard pressed for cash may find difficult to resist. When alerted to situations where the financial condition of an industry member is becoming precarious, we heighten our degree of oversight and also utilize commercially available data to confirm suspicions or obtain early warning of future trouble.

The implementation of tax payment by electronic funds transfer has changed the documentation of excise tax payments. Inspectors and auditors in the field will be provided the information they need to make adjustments. We are also working to ensure that IRS processing of the transfer records and the allied tax returns will provide the necessary documentation in a timely manner.

In the tobacco program, the implementation of the FY 1983 tax increase has been completed with the conclusion of remaining examinations of floor stocks tax payments. Over $1.3 million in adjustments resulted from these examinations. For FY 1986, we are projecting a reduction in the amount of collections since cigarette taxes are scheduled to revert to the former lower rates.

Alcohol Qualification and Market and Product Integrity

In all of our market and product integrity programs, the Bureau has one overriding goal: to provide the maximum service to our constituents (the public and the industry members), with a minimum of disruption to the normal operation of the marketplace. Our strategy is to make market and product integrity examinations more systematic so that problems are detected at an early stage, or prevented altogether, thereby limiting any potentially adverse impact on the industry members involved or the general public.

The proposed FY 1986 staffing level will reduce regional activity in this project and focus national investigations on the highest priority cases impacting competitive conditions in the industry.

Legal Alcohol Industry Strategy

Under the FAA Act, the Bureau is responsible for keeping prohibited and/or unqualified persons out of the legal alcohol industry. Our qualification activity is the first line of defense against such infiltration.

Ownership and control investigations are a major part of our market integrity strategy. The Law Enforcement Crime Impact Program, and various crime commission studies, have revealed evidence of organized crime involvement at the retail level. We

believe it is our responsibility to determine just how involved criminal elements may be at the producer and supplier levels, where special business interests (including organized crime) may have infiltrated through hidden ownership and control after original permit qualification. We are placing emphasis on disclosing instances where ownership and control of these enterprises is concealed. Through training and dissemination of information, we are making our personnel more alert to the potential of hidden interests. We are also highlighting the importance of what may seem to be routine qualification or change of control investigations to attune these personnel to possibilities of concealed interests. Hidden ownership, while not a separate program of itself, is an integral part of the overall FAA Act compliance program.

We also have continued our traditional FAA trade practices program with substantial results in this past year. A major national investigation culminated in the payment of a $2,000,000 offer-in-compromise and the filing of a consent decree in Federal court. Under the terms of the consent decree, future violations of the same type by the industry member will constitute criminal contempt. Ongoing investigations include several involving nationwide trade practices of major industry members.

In enforcing the FAA Act, ATF aggressively pursues cases where major, serious violations are suspected, while taking a more lenient approach in cases involving only technical, non-serious violations. We conducted investigations of unfair trade practice activities in the beverage alcohol marketplace as a result of information we had discovered, as well as on the basis of complaints made by industry members. We have attempted to foster a spirit of cooperation among ATF, the beverage alcohol industry, and State officials to ensure an orderly marketplace in which all competitors play by the same rules.

International Actions

The Bureau has been quite successful in efforts to correct problems with respect to imported beverage alcohol and to promote stability in that market.

As the Committee knows, our compliance activities are directed toward domestic and imported products alike. It is our policy to ensure that all alcohol beverages are accurately labeled and enjoy an equal opportunity for open competition in the U.S. market.

Although we are aware that it is not our mission to promote foreign trade, we do believe we have the responsibility to try to harmonize requirements. In so doing, we have worked with the Office of U.S. Trade Representative to eliminate foreign regulatory obstacles which restrict U.S. access to export markets. For example, the Bureau has fulfilled an essential role in the technical consultations which have been taking place with the European Community (EC) over the past several years. U.S. - EC accords were formalized in July 1983, outlining areas of tentative commitment concerning enological practices, EC certification requirements for U.S. and EC wines, labeling standards and procedures, and wine fraud investigations. FY 1984 was marked by progress in the implementation of the accords through regulatory and administrative actions by the EC and by ATF. We anticipate continued progress and additional consultations in FY 1985 and 1986.

Other more directly responsible Federal agencies have come to realize that ATF's regulatory authority and technical competency with respect to U.S. beverage alcohol products and imports naturally lends itself to involvement in international activities. We will continue to meet our responsibilities in these areas and to assist other U.S. Government agencies which may benefit from our expertise and experience in regulating the production and marketing of beverage alcohol products.

Firearms Program

Compliance operations in the firearms industry support the Bureau's law enforcement concentration on this program. Inspectors

often work closely with law enforcement personnel in targeting licensees for compliance inspections. This approach has proven effective in Miami, the Summer Olympics project, and other task force operations. Staffing for firearms work is distributed so as to complement ATF law enforcement presence, especially in the 13 OCDETF cities.

The statutory basis for our firearms compliance operations is in the licensing and other regulatory requirements imposed by the Gun Control Act of 1968 (GCA) and other statutes. Licenses to manufacture, import, and sell firearms are required by the GCA in order to provide for an orderly flow of legal firearms from the manufacturer to the retail sales outlet and to prevent the criminal misuse of firearms. In part, this orderly flow depends upon preventing certain "prohibited persons" from obtaining a firearms license. Prohibited persons include convicted felons, illegal aliens, and drug addicts, not the law-abiding citizen.

This past year, we processed approximately 39,000 new applications and 164,000 renewal applications for licenses. Fewer renewals will be processed in FY 1985, FY 1986 and subsequent years due to our conversion to 3-year licenses. License issuance is an area where we have made great strides in automation. In the near future, we expect to provide faster service at less cost by utilizing commercial lockbox services to handle receipt and deposit of license fees, pursuant to a cash management pilot project.

Applications examiners in each regional office review all applications for completeness. A field investigation may be requested if the criminal record check or other information indicates an irregularity. We also select applicants for routine personal contacts based on predetermined criteria, concentrating on high-crime areas. This presents an opportunity to explain the requirements of the Act and to respond to any questions or problems the applicant may have.

National Firearms Act (NFA) weapons and firearms import operations are centralized in Bureau Headquarters. These branches administer special tax and registration provisions applicable to NFA weapons (e.g. machine guns) and the importation regulations issued under the Gun Control Act of 1968 and other statutes. The workload of these branches has continued to grow over the past several years. Initiatives to apply automation to many of the functions of these operations are under way.

Firearms compliance activities support law enforcement efforts by maintaining the integrity of the firearms recordkeeping system, enhancing crime gun tracing capabilities, and reducing the potential for criminal misuse of a firearm. This is accomplished through selective field inspections, which not only ensure compliance with the law, but also provide information and assistance to licensees.

Accurate and complete licensee records increase the likelihood that, when we receive a request from a Federal, State, or local law enforcement agency to trace a firearm that has been used in a crime, we will be able to complete the trace. Many times a successful trace means a successful prosecution of a criminal offender. An unsuccessful trace can likewise be related to inaccurate or incomplete records.

We also recognize our responsibilities to legitimate business people and gun-owning citizens who sincerely want to abide by the law and therefore have chosen to put a significant portion of our Compliance firearms resources into an educational campaign built around locally-held seminars. In FY 1984, 5,347 persons attended 91 firearms seminars.

These seminars are held in major metropolitan areas with heavy concentrations of firearms licensees. General invitations are sent to all dealers and interested parties in those areas. The seminars have been enormously popular with the local dealers and State and local law enforcement authorities who have attended.

Explosives Program

The explosives compliance program ensures that those involved in the explosives industry meet the requirements of law and regulations, including licensing and permit provisions. We conduct inspections which protect the public safety by ensuring proper storage of explosives. Improper storage of explosives can threaten public safety in two ways: accidental detonation or theft for misuse (e.g. in a terrorist situation). A combination of inspections and educational initiatives are employed to ensure that explosives are stored safely and securely, free from risk of theft.

Explosives compliance inspections of most licensees and permittees are conducted on a regular basis. Operations judged to entail a higher degree of risk, such as fireworks facilities, have top priority and are inspected more frequently. In FY 1984, inspectors detailed to the Los Angeles area carried out an intensive inspection effort in connection with the Summer Olympics. In FY 1985, an accelerated inspection program is planned to take a fresh look at all establishments regarding potential for public harm.

We have also begun to apply the seminar approach in this industry. For FY 1985, all regions have planned explosives seminars which will include local representatives from Federal and State regulatory agencies. Through these seminars and attendance at meetings of the national industry associations, we will be working to provide the least burdensome Federal regulation of explosives that can be achieved consistent with existing or enhanced levels of public safety.

The ATF-initiated Interagency Committee on Explosives continued its work in FY 1984. The Committee, which is made up of representatives from 20 Federal agencies, will continue to direct its efforts toward the elimination of the regulatory confusion resulting from the profusion of independently developed standards, definitions, and regulations promulgated by the various Federal agencies charged with the regulation of explosives.

EQUAL OPPORTUNITY PROGRAM

Finally, but by no means least important, I would like to report on the equal opportunity activities of the Bureau.

Our primary effort continues to be to make equal opportunity an operating program with responsibility for accomplishment shared equally by each major functional area. Executives and managers are fully aware of their responsibilities and all are aware that their performance will be evaluated on how well they meet these responsibilities.

The Bureau has made outstanding progress during the past 2 years in affirmative action. The progress is due to the persistent support of affirmative action for minorities and women by management at all levels in the Bureau. The Bureau is continuing in its aggressive recruitment campaign to restore the overall profile of minorities and women to the workforce.

Significant efforts to recruit minorities and women were evident during the past year. Of the 560 employees hired during FY 1984, 78 percent were minorities and women. The President's Initiative on Historically Black Colleges and Universities, Executive Order 12320, and the Federal Equal Opportunity Recruitment Program (FEORP) continue to be stressed in our recruitment effort. Recruitment visits continued again this year to schools with heavy Black and Hispanic populations to identify the most highly qualified candidates. At each school, efforts were made to interest women in the essentially nontraditional occupations of inspector and special agent which carry out the Bureau's compliance and law enforcement responsibilities.

Finally, we prepared and forwarded to the Equal Employment Opportunity Commission the second accomplishment report under our 5-year plan. Achievements continue in our established goals and objectives.

Mr. Chairman and Members of the Subcommittee, this completes my statement. I will be happy to answer any questions you or members of your Committee may have.

ARIEL RIOS HEADQUARTERS OFFICE

Mr. HIGGINS. Mr. Chairman, I'd like to express my appreciation to you for introducing a bill to rename our headquarters office in tribute to our agent, Mr. Ariel Rios, who was the first Federal officer killed while serving with the south Florida task force. I would also like to thank Senators Laxalt, DeConcini, and Mattingly for cosponsoring the bill which means so much to members of ATF.

Senator ABDNOR. I think other Senators joined in that who are not members of this subcommittee. They feel strongly about that.

Mr. HIGGINS. Thank you.

INTRODUCTORY REMARKS BY MR. HIGGINS

Mr. Chairman, accompanying me today are my associates, Mr. William Drake, Associate Director, Compliance Operations; Mr. Phillip McGuire, Associate Director, Law Enforcement; Mr. Chester Bryant, Comptroller; and Mr. Paul Gentille, Financial Manager. Since this is Mr. Bryant's first appearance before the subcommittee, I would like to submit his biography for the record.

[The information follows:]

BIOGRAPHY OF CHESTER C. BRYANT

Chester C. Bryant assumed his present position of Acting Comptroller in October 1984. Since joining the Bureau of Alcohol, Tobacco and Firearms as a special agent in 1965, Mr. Bryant has held numerous positions of increasing responsibility, including: Resident agent in charge at Macon, GA; assistant special agent in charge at Austin and Houston; and two managerial positions at headquarters. He subsequently became special agent in charge for the Nashville district office in October 1979. Mr. Bryant served in this capacity until July 1984 when he was designated Acting Compliance Regional Director.

His current duties involve planning and executing ATF's support activities, which include financial management, personnel, data processing, communications and office automation, administrative programs, training, management analysis, and the full range of laboratory and scientific services.

Mr. Bryant was born on July 23, 1939, in Grantville, GA. In addition to graduating from Harris College in Houston, TX, he has completed graduate course work at Vanderbilt University and numerous law enforcement and executive development seminars. Mr. Bryant's family, which includes his wife Brenda and two children, Michelle and Chester, Jr., will soon be residing in the Washington, DC, area.

BUDGET REQUEST

Mr. HIGGINS. Our fiscal year 1986 budget request is $169.6 million and 2,850 staff-years, which represents a net decrease of $2,551,000 and 91 staff-years in comparison to fiscal year 1985. This request includes program reductions and savings of $9.084 million and 91 staff-years partially offset by an increase of $6.533 million to maintain current levels of operation. These requirements are discussed in greater detail in our fiscal year 1986 budget justification in the general statement.

CURRENT ACCOMPLISHMENTS

Fiscal year 1985 to date has been a very demanding, yet rewarding, period for ATF. Our special agents, inspectors, and support personnel have been faced with unprecedented challenges and have met those challenges with a good deal of success.

In our Law Enforcement Program areas, we have the jurisdiction, the experience, and the personnel to have an impact on the incidence of violent crime disproportionate to our numbers.

Our enforcement activities focus primarily on violations of Federal criminal statutes relating to explosives, arson, firearms, alcohol, and cigarette smuggling. Bombings, attempted bombings, arsons, and explosives thefts receive our highest investigative priority because of the potential for loss of human life. Intimidation by threat of use of explosives causes public fear and unrest if allowed to go unabated.

Perhaps the most widely publicized current examples of attempts to intimidate by bombing and arson is the recent series of attacks on abortion clinics and related facilities. ATF has investigated 32 such incidents since mid-1982. To date, we have closed 22 of these investigations by arrest, with several defendants already serving lengthy prison terms. Since bombing and arson crimes are among the most difficult crimes to solve, we are quite proud of our success in these cases. Overall, our solution rate in arson and bombing incidents far exceeds the national average.

Because violent criminals pose a serious danger to the public safety through their criminal misuse of firearms, they also receive a high priority. Firearms investigations are directed at illegal sources of weapons, as well as criminals who use firearms to commit crimes. We would much prefer to arrest a trafficker in illegal weapons before he distributes them than to apprehend a criminal after he has committed a violent crime resulting in the loss of innocent lives.

During the 1984 Presidential campaign year, ATF expended 131 staff-years in protecting candidates. A portion of our commitment to the U.S. Secret Service, 15 staff-years, will carry over to fiscal year 1985. It should be noted that at one time during the campaign ATF had 370 special agents detailed to candidate and dignitary protection.

We appreciate the confidence that the U.S. Secret Service has in our ability. We believe this reflects on the professionalism of our field agents and has further reinforced our working relationship with our sister agency.

PRODUCTIVITY AND MANAGEMENT IMPROVEMENTS

ATF's regulatory philosophy is to regulate only where needed, and then only to the extent necessary to accomplish the intent of the statutes. While regulation of socially and politically sensitive commodities for which the Bureau has responsibility cannot be eliminated entirely, we believe that regulations and paperwork can be reduced to a minimum while maintaining an efficient and effective administration of Federal statutes.

One of our objectives is greater selectivity in the utilization of resources so that the Government and the taxpayer will derive the greatest possible net benefit from resources committed to our programs. We try to gear the regulations and our activity directly to the degree of risk or jeopardy. We also match requirements and regulatory oversight to the size of the operation and the scope of the regulated activity.

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Our major programs as discussed in the general statement illustrate our efforts to reduce regulatory intrusion and to optimize benefits.

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The Bureau has made significant progress during the past 2 years in affirmative action. The progress is due to the persistent support of affirmative action for minorities and women by management at all levels in the Bureau. The Bureau is continuing in its aggressive recruitment campaign to restore and increase the overall profile of minorities and women to the work force.

AGENCY MORALE

On numerous occasions, I have been asked about agency morale. I have always been inclined to hedge that question on the premise that the head of an agency will say that morale is great no matter how bad things really are. Today, I am not even going to wait for the question. It is my sincere belief that morale is high, commitment is strong, and our organizational pride has never been as widely shared or deeply felt as it is today.

With the continued support of the administration and the Congress, particularly this subcommittee and your counterparts in the House, ATF will continue to deliver quality law enforcement and compliance efforts in fiscal year 1986 and beyond.

We will be happy to answer any questions you may have.

CIGARETTE TAX

Senator ABDNOR. Thank you, Steve. I want to commend you and your people for the very fine job you are doing. We appreciate it. You have some difficult tasks in front of you.

Let me talk about the cigarette tax for a minute. I remember a few years ago we were going to drop it and then the Treasury decided they wanted it.

We left it in, and they said leave it in, and now we are talking about taking it out. Could we reach some conclusions on that before the budget is put together?

I do want to ask you about the cigarette tax. In your budget for fiscal year 1986, it anticipates the rollback. What will the impact be on the ATF if the tax is not rolled back?

Mr. HIGGINS. Fortunately, it is a limited number of taxpayers we are concerned with it in the first place, each paying a relatively high amount of taxes. In terms of audit workload for us, it will remain fairly consistent. When the tax was doubled a couple of years ago, we did not request additional resources because we felt we had the audit capacity to make those taxpayer . dits and assure collection of taxes. We think that when it goes back down, obviously we will still have the ability to do that, and we see it having relatively little impact.

ALCOHOL PROGRAM REDUCTION

Senator ABDNOR. Your fiscal year 1986 budget proposes a significant reduction in the Alcohol Compliance Program, and I wonder if we have a problem with the reduction, noting here that this reduction was being made because the Tobacco, Firearms, and Explosives Programs are already at the minimum levels.

Does this mean that you have not been provided enough resources to fund the ATF programs?

Mr. HIGGINS. In terms of the reduction of the budget, we will have to be more selective in the targets of the alcohol revenue area, and we do have some programs that we believe will do that. In the enforcement of the FAA Act, we will concentrate our efforts on investigations of national importance. We will be reducing our investigations of regional and market area violations. So there will be a shift of focus within the Alcohol Program.

Senator ABDNOR. That will be quite a challenge for you, and we will be watching you, too, because we are concerned about that.

ARSON PROGRAM

As you are probably aware, I am interested in the Arson Program. It is frankly a very effective program. Can you discuss the status of the Arson Program and where it is headed?

Mr. HIGGINS. We are doing a number of things in the Arson Program, and it is one of our highest priority programs.

One approach we found to be exceedingly effective is working in arson task forces with the major cities in this country. We have task forces in 13 cities now, and we intend to add another task force city during fiscal year 1985, bringing the total to 14. We often work in the same offices with the city police and fire officials on the task forces, and we do believe this approach, that is, utilizing our abilities and their abilities is both a sound and effective method of combating the arson problem.

We also do a significant amount of training for State and local fire and police officials so that we can improve their ability to respond to arson, and especially arson for profit, which is an area that requires additional investigative ability.

Beyond that, we are using our national response teams. We have four of them throughout the country, used in responding to major arsons.

So it is an important program for us. We are coming at it from a number of fronts.

Senator ABDNOR. Fine. Then the teams are located in 13 cities, you say?

Mr. HIGGINS. We have recently added a 13th, and we will be moving into a 14th city.

Senator ABDNOR. These people, do they go out to other cities, if necessary?

Mr. HIGGINS. The 13 arson task forces are located in cities that have had particularly bad experience with arson, such as Boston, Philadelphia, or Chicago. We do have both our national response team, and other trained investigators who will go to other cities and provide assistance where it is needed. We have the ability to respond.

DISTILLED SPIRITS FLOOR STOCKS TAX

Senator ABDNOR. In terms of the Bureau's abilities to ensure tax collections and compliance with the related laws, what will be the impact of increased distilled spirits taxes at the beginning of the fiscal year? Should greater resources be spent on this program?

Mr. HIGGINS. I think the most immediate impact, Mr. Chairman, will be that there is a floor stocks tax that is imposed. That means that any individual who has distilled spirits in inventory down to the retail level as of the effective date of the tax increase, will have to take an inventory and pay the taxes on that inventory, plus an additional $2 per proof gallon.

We expect about 300,000 people throughout the country will be filing returns. We are, therefore, developing a program for auditing those returns on a very selective basis.

Based on our experience with the cigarette tax increase and the floor stocks adjustment there, we can expect that there will be a fairly high degree of noncompliance. We found in the cigarette floor stocks tax project that we had about 9,000 taxpayers, and with distilled spirits we have about 300,000. We also have to pay additional money to IRS. IRS receives the returns and processes them to make sure the money is

deposited. We will have to absorb the internal cost of having IRS do that. If we had additional resources, we could audit the additional tax returns.

ALCOHOL BEVERAGE ADVERTISING

Senator ABDNOR. In addition to unlawful trade practices, the Bureau, ATF, has jurisdiction and is concerned with consumer protection in labeling and advertising.

How does the increased interest in such issues as alcohol, health, television advertising, and so on fit into this program?

Mr. WALKER. Mr. Chairman, the issue of advertising for alcoholic beverages has been the subject of some public interest, and it is one that is currently finding voices in the community, particularly from the interest groups involved.

But at present, we do not foresee any impact on that as far as ATF's budget is concerned. So I don't feel there would be a change in that regard.

Senator ABDNOR. Is it a possibility that if something is done that would change your thinking? I mean, you are assuming——

Mr. WALKER. Well, obviously, if circumstances changed we would be monitoring the situation to see whether there was a need for additional resources. But right now the kind of advertising that has been in place is continuing. If and when that should be changed, then, you know, one would have to assess the situation at that time.

Senator ABDNOR. Fine.

ABORTION CLINIC BOMBINGS

Well, as a result of your recent experience in handling the abortion clinic arson and bombing incidents, what does ATF procedurally or operationally do different than they did before the incidents? Have you had to change your approach?

Mr. HIGGINS. I think fortunately, Mr. Chairman, almost initially we considered them to be major investigations, and coordinated them through the headquarters office. We have not had to change our procedures to any great extent.

They are monitored nationally. We have a coordinator here who monitors developments between the field and in the offices where those are occurring not only to get some indication as to whether or not the same people are involved, but also to share leads and intelligence.

We are also providing support here out of the laboratory system and through our national response teams. So we had the system of a national investigation and regular monitoring. It did not result in any major changes.

Senator ABDNOR. In spite of your solution rate and your obvious expertise, does ATF have the resources to deal with future incidents of this nature?

Mr. HIGGINS. Yes, sir, I believe within reason and assuming that we don't have any greater numbers than we have had to this point. It is

our No. 1 priority. We do have the support of the Secretary of the Treasury and Assistant Secretary Walker in committing to us any assistance they can in handling those kinds of incidents.

So I think with that kind of support, the quality of the people that we have working on them, and the laboratory and response teams, I believe we can handle the problem within reason.

Senator ABDNOR. With all our Treasury law enforcement agencies, it is rather difficult to always anticipate what is going to happen in that fiscal year. You still have a budget. It takes a little closer following, on our part, and I guess yours, too, to keep us informed, but I know you will do just that.

ADDITIONAL COMMITTEE QUESTIONS

I have a number of questions that I will submit to you in writing if you don't mind.

With that, I thank you, and once again tell you what a fine job you and your people are doing, and we look forward to working with you.

I want to thank all our witnesses for participating in today's hearings. I am pleased with the testimony, and the exchanges that we had, and it will be most helpful as we go through the appropriations process.

[The following questions were not asked at the hearing but were submitted to the Bureau for response subsequent to the hearing:]

Additional Committee Questions

FIREARMS LICENSEES

Question: How does the Bureau deal with the disparity between the large and still growing population of licensed firearms manufacturers, importers, and dealers, and the limited resources available for a compliance program?

Answer: Resources are allocated and inspections targeted to best support the Bureau's law enforcement focus on combatting the criminal misuse of firearms. Most compliance inspection activity is geographically concentrated in Organized Crime Drug Enforcement Task Force (OCDETF) cities, other high-crime SMSA's, and other areas where ATF's law enforcement effort is most active. Emphasis is placed on licensees most likely to divert firearms from legitimate trade to criminal misuse, including referrals from Federal, State or local law enforcement and licensees with a history of poor compliance. Our program also targets certain classes of licensees considered to be higher risk categories for more frequent inspection.

We have also continued the firearms seminar program as a way of reaching licensees who will voluntarily comply given adequate information. In FY 1984, 5,347 persons attended 91 firearms seminars. The seminars are held in local areas with a sufficient concentration of licensees to support a seminar. General invitations are extended to all dealers and other interested parties in the area. In addition to being well received by the licensee community, the seminars are very popular with State and local law enforcement authorities who attend.

We have automated the licensing and renewal systems and are continuing to improve these systems.

INTERNATIONAL ALCOHOL TRADE

Question: With the growth of the American wine industry, access to export markets is of vital importance. Can you update the committee on the purposes and progress of ATF activities that facilitate international trade?

Answer: ATF's efforts are to harmonize requirements internationally, and to reduce or eliminate non-tariff trade barriers, related to both day-to-day activities and longer-term endeavors. At the request of U.S. exporters, we have on many occasions dealt with foreign governments to obtain release of shipments delayed due to slight paperwork deficiencies or minor technical misunderstandings. Through our role in the U.S. - E.C. wine consultations and as the most active U.S. Government participant in the International Office of Vine and Wine (OIV), we are working to harmonize technical requirements regarding alcohol beverages.

The following developments resulting from the U.S. - E.C. consultations represent significant progress:

- The E.C. gave recognition to use of the term "Estate Bottled" for U.S. wine.
- U.S. geographical designations and approved viticultural areas were also recognized.
- Agreement was reached on recognition of 164 grape varietal designations.

- The E.C. agreed to permit the use of additional labels for mandatory information on wines exported to E.C. member countries. This move will save time and money for the U.S. wine industry by allowing strip or neck labels for new and/or additional information without replacing the labels already on the bottle.
- The E.C lifted the compensatory charges that had been levied on U.S. wine exports to the E.C.
- In June 1984, the E.C. formally gave recognition to the enological practices of the U.S.

At the request of U.S. industry, we have conducted studies of the import requirements of countries which are viewed as significant potential markets for U.S. exports. At the present time, we are preparing for release an industry circular detailing requirements for entry into the Japanese market.

ABORTION CLINIC BOMBING INVESTIGATIONS

Question: Are you continually coordinating abortion clinic investigations in any manner to ensure that future incidents indicative of a national conspiracy would be recognized?

Answer: The abortion clinic incidents have been prioritized by ATF to ensure that all abortion clinic investigations nationwide are monitored and coordinated at ATF Headquarters.

There is a continual exchange of information between Headquarters and management in the field so that progress in each investigation can be determined. Similarities, should they surface, can also be analyzed immediately to determine if the incidents are connected in any way.

Question: We keep reading and hearing statements concerning a national conspiracy to bomb abortion clinics, yet your testimony indicates otherwise. How do you explain this?

Answer: Few criminal acts bring such widespread concern to the hearts of our citizens as a bombing. A bombing is a violent and despicable act. Both the victims and the general public have a right to be concerned.

Sentiment concerning the abortion issue, both for and against, seems to cover the spectrum for religious and political philosophies. Almost everyone has a position on the issue. It is also easy for people, including the media, to become partially informed on this issue and make erroneous conclusions. Obviously, the conspiracy issue is one we constantly examine as we do in all investigations.

The only common denominator between these crimes appears to be an anti-abortion sentiment carried to violent extremes.

The name Army of God has been publicized and is available for use by anyone, particularly by the type of individual who expresses his views through threats of violence.

Question: What is ATF doing to deter future violent actions against abortion clinics?

Answer: ATF's approach to deterring violent actions against abortion clinics is two-fold. First, by a professional investigative effort, criminal actions have been initiated against 14 defendants since 1982. To date, 5 of these defendants have been convicted and are serving lengthy prison sentences. Criminal action is pending

against the remaining 9 defendants. We feel that the deterrent effect will have a significant impact on future incidents.

Secondly, on the local level, ATF field offices have been in contact with potential targets, advising them on the security measures that can be taken to deter violence against their facilities.

ATF has produced a building vulnerability assessment study. The information contained in this study has been broadly distributed to national organizations concerned with the abortion issue.

Question: Has ATF utilized its National Response Team in any of the abortion clinic arson/bombing incidents?

Answer: Yes, ATF has activated the National Response Team (NRT) to bring 4 of these incidents to a successful conclusion. A gag order prohibits us from elaborating on details as to how the NRT enhanced ATF's efforts in the specific investigations.

The teams have not been activated in all arsons/bombings of abortion clinics because the majority of incidents did not involve extensive "scene" investigations and district ATF personnel and State/local authorities had sufficient resources to handle the initial stages of the investigations. It should be emphasized that the principal purpose of the NRT is to concentrate manpower and state-of-the-art equipment during the early crucial hours of an investigation in order to prevent the loss or destruction of evidence. ATF NRT's have responded to 113 incidents in which 60 people were killed, 322 injured, and which destroyed $340 million in property. The NRT enjoys a 60 percent success rate among incidents it has investigated.

IMPORTED TOBACCO PRODUCTS

Question: To what extent does BATF regulate these imported tobacco products? Do they carry the same warnings required on domestic cigarette packages? Are you aware of any federal analysis of the additives peculiar to these imported cigarettes, such as clove extract? Has any consideration been given to whether these additives are likely to provoke allergic reactions in some users?

Answer: Since our jurisdiction over cigarettes is limited to taxation, ATF has not been involved directly in the clove cigarette controversy. As you indicated, these are tobacco products which contain a significant proportion of cloves. In Indonesia, where they are known as "kreteks," they have been consumed for over a century. In the United States the product is taxable the same as any other cigarettes, and the packages are required to bear the health warning. It is our understanding that there have been no meaningful studies, in Indonesia or elsewhere, of the health consequences of smoking these products. Because of this lack of information, the Center for Disease Control is just beginning a long-range study in an effort to determine if there are any health hazards associated with their use.

ALCOHOL OCCUPATIONAL TAXES

Every wholesale and retail alcohol establishment must pay a yearly occupational tax before they can legally engage in business. The Bureau of Alcohol, Tobacco and Firearms (BATF) has long recognized that compliance with the retail occupational taxes should be improved.

Question: BATF stated in the past that 95% would be an acceptable compliance level for the retail occupational taxes. What is the current level of compliance with these taxes? If it is less than 95%, what is being done about it?

Answer: Based on field work in which ATF assisted GAO in FY 1984, the raw data on a sample of retailers from the States of California, Florida, Illinois and Texas showed a 60 percent compliance rate. While statistical projection of the data, results of which are not yet complete to our knowledge, may show a slightly different rate, the preliminary results are in agreement with our own historical estimates based on comparison of collections reported by IRS with numbers of retailers reported by trade groups. Steps to improve compliance have been constrained by the large number of taxpayers versus available resources. The resources required for an effort that would include field follow-up on a large scale, comparable to the effort expended in following up on the dealers surveyed by ATF and GAO, are not available given the higher priority we feel must be assigned to other programs, especially the billions of dollars in alcohol gallonage and tobacco taxes for which ATF is responsible.

We have a number of ongoing initiatives aimed at disseminating information about the special tax requirement in order to improve compliance. These include working with trade associations, public service advertisements run in trade publications, and solicitation of State cooperation in reminding licensees and new applicants about the tax requirement and furnishing tax returns. We are in the process of developing a program that would follow up on IRS reported delinquencies and State reports of licenses issued using stay-in-school personnel working from ATF regional offices. The program will utilize data and techniques refined in the process of verifying distilled spirits floor stocks tax payments.

Question: The "Grace Commission" study addressed retail alcohol occupational tax compliance and made two recommendations to improve compliance. One of the recommendations called for restricting the sales by wholesalers. This required legislative action. BATF forwarded draft legislation to the Department of Treasury about one year ago. What is the status of the draft legislation? Does BATF agree or disagree with the other Grace Commission recommendations that IRS match tax payment records to identify potentially noncompliant taxpayers?

Answer: The draft legislation is at OMB pending clearance. This status has been unchanged for about one year. The Grace Commission recommended that PIA (Principal Industry Activity) codes included on business returns be used to identify potential liquor retailers for matching with special occupational tax rolls. This is impractical because retail dealers in beverage alcohol products would show up under a number of codes along with non-retailers (e.g. drug and grocery stores, restaurants, etc.). Given the right data bases we agree that matching can be very productive. This is why we support the matching project involving distilled spirits floor stocks taxpayers and retail occupational taxpayers that is mentioned below.

Question: What procedures are in place to ensure that once a taxpayer has established a filing requirement he/she continues to pay? Specifically, what procedures are followed by IRS and BATF if a taxpayer of record stops paying his or her occupational taxes?

Answer: As we understand IRS procedures, some IRS service centers may be issuing reminder letters to taxpayers of record who fail to renew their special occupational tax stamps. There is no IRS field follow-up unless the taxpayer is delinquent on other taxes and the Form 11 delinquency is posted to the file as an additional item for collection. Typically IRS refers a TDI (Taxpayer Delinquency Investigation) to ATF in all cases where taxpayers fail to renew. Given staffing constraints, there is little follow up on these. Also, given the fairly high turnover rate among retail businesses, many of the TDI's may reflect businesses closing or changing ownership rather than a continuing business's failing to pay. Under the program we are developing (see prior question on this subject), the IRS TDI's would be one source of leads for office inquiries.

Question: BATF has argued against the repeal of the retail occupational taxes because the agency feels it is a useful means of keeping organized crime out of the liquor industry. Please explain how it is useful and provide the data that demonstrates the usefulness of these taxes in keeping organized crime out of the industry.

Answer: It is not the special occupational taxes that would impact organized crime involvement in the retail liquor industry, but rather the legal requirement to reflect actual, true ownership of a retail establishment. The IRS Form 11 is the document that requires the retail business to show who really owns the concerned business.

Organized crime groups have been known to favor retail liquor dealerships as a vehicle to launder money and to create additional capital. In many instances, State and local retail licenses are issued to corporations, etc., and/or to "straw" owners. Falsification of a State or local application would not necessarily result in a Federal case. However, if the Form 11 were falsified that would result in a Federal interest.

Question: BATF is considering using the names of retailers filing excise tax returns for alcoholic beverages on hand as of October 1, 1985, as required by the Tax Reform Act of 1984, to identify potentially delinquent occupational taxpayers. What is the status of this? Has BATF determined how to follow-up on taxpayers which fail to respond to a letter of inquiry?

Answer: This plan is still active. The original lists of potential taxpayers will be prepared from State files of retail distilled spirits licensees. Those filing returns should include only such licensees and the return will include IRS identifying numbers (EIN) which makes the match against special tax files much more accurate.

Follow up will depend on the numbers of the 300,000 estimated filers identified as potential delinquents. Field follow up will have to be very limited since, over and above other higher priority tasks, we will be faced with the need to verify the distilled spirits floors stocks returns that are the source of the data for the match. We would follow up initially with correspondence and/or telephone contact from ATF regional or field offices. Since we would be dealing with people who had identified themselves to us as dealers in connection with the floor stocks return, office contact should be sufficient to encourage a high percentage to satisfy their special tax liability.

FIREARMS OCCUPATIONAL TAXES

The National Firearms Act (NFA) of 1934, as amended, created the firearms occupational and related excise taxes to control a certain class of weapons (machine guns, silencers, explosive devices, etc.). The law imposes yearly occupational taxes on the manufacturers, importers and dealers of NFA weapons. In addition, related taxes are also imposed on each weapon transferred or made. Certain exemptions from the per-weapon transfer taxes are allowed such as transfers between occupational taxpayers.

Question: BATF has long believed that many gun collectors are obtaining federal NFA dealer status to avoid the per-weapon tax on transfers. In 1976, BATF issued Ruling 76-22 to curb the perceived abuse. However, Ruling 76-22 has not solved the problem according to BATF officials. What problems has the agency encountered in attempting to invoke Ruling 76-22? What changes does the BATF feel are necessary to address the perceived abuse of the tax provision allowing tax-free weapons transfers?

Answer: There are a number of problems with invoking ATF Ruling 76-22 that limit its usefulness as an enforcement tool. These include:

* To invoke ATF Ruling 76-22, we must determine whether the licensee is "engaged in the business." Under the law, any firearms business activity would affect this status. For example, even though the licensee does not appear to be engaged in activity other than acquisition under Title II (NFA weapons), if Title I sales are being made that licensee is most likely engaged in the business.

* ATF does not have the personnel resources which would allow us to examine the activities of each licensee who has paid the special occupational tax. There are currently 2,890 licensees who have registered with ATF as having paid the special tax. In FY 1984 there were 2,678 special taxpayers.

* Finally, our recourse in cases where we determine that the licensee paid the special occupational tax merely to avoid paying transfer taxes is limited. If we assess the transfer taxes, we would have to assess the person who transferred the firearms to the subject licensee. To take seizure or forfeiture action on the firearms requires the prior presentation of a criminal case to the United States Attorney.

We feel that statutory changes are necessary to address this problem. One alternative would be to provide authority in Title 26 USC, Chapter 53, and in the implementing regulations Title 27 CFR, Part 179, to allow administrative action to be taken under these sections alone regarding business activity. The statute could also be amended to provide for tax liability on the part of the transferor, the transferee, or both. Another alternative would be to require that any NFA firearm acquired under the licensee's special tax status must be transferred out of the business inventory before termination/expiration of the special tax status. Sole proprietors are now allowed to retain their business inventory upon the expiration of the special tax status without having to transfer the firearms or incurring transfer taxes. This latter statutory change would eliminate this problem.

Question: Twenty-eight states do not allow individuals to possess NFA weapons. However, 11 of the 28 states do allow NFA dealers to possess the weapons. What happens to a former dealer in

these 11 states that continues to possess the NFA weapons and are they in violation of federal law? GAO contacted several state attorneys general and found that many of the former dealers may unknowingly be violating state law by continued possession of these weapons. What could BATF do to address this problem?

Answer: A special occupational taxpayer, who allows his or her special tax status to expire in a State that does not allow possession by individuals and who retains in the inventory NFA firearms that are controlled by that State, would only be in violation of the State law, not Federal. ATF's authority with regard to State or local laws governing NFA weapons extends only to the approval of the application, i.e. the transferee is in compliance with State or local law at the time of approval of the application for transfer. In the case of a special occupational taxpayer who operates as a sole proprietor, there is no "transfer" when the licensee discontinues business because any firearms in inventory are already registered to the same individual.

We do not feel that many of these dealers are unknowingly in violation of State law by their continuing possession. If a licensee in a controlled State attempts to make sales, the licensee will quickly become aware of the restriction. Further, if the licensee submits an application to transfer an NFA firearm where receipt or possession of the firearm would place the transferee in violation of State or local law, ATF would disapprove the application and give the reason why.

We also feel that in some cases, the licensee uses the special tax status to acquire an NFA firearm that would otherwise not be available in the State and then retain the firearm upon expiration of the special tax status. This situation relates to your other question on use of special occupational tax status to avoid transfer taxes. Because of the restrictions in the law, we can not release any information about the tax status or registered firearms pertaining to these licensees to the State or local authorities.

For those licensees who are unknowingly in violation, we have information concerning a licensee's operations as a special taxpayer available in an ATF publication, Your Guide to Federal Firearms Regulation. This information will be amended to advise those special taxpayers who are in controlled States of their possible violation of State or local law if they cease special tax status and retain an inventory.

SUBCOMMITTEE RECESS

Senator ABDNOR. If there is no further business to come before the subcommittee, we will stand in recess until 10 a.m., Wednesday, April 17, when we will receive testimony from the U.S. Customs Service.

[Whereupon, at 11:37 a.m, Wednesday, April 3, the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, April 17.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

WEDNESDAY, APRIL 17, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:10 a.m., in room SD–124, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, DeConcini, and Proxmire.

Also present: Senators Chiles and Domenici.

DEPARTMENT OF THE TREASURY

U.S. CUSTOMS SERVICE

STATEMENT OF WILLIAM VON RAAB, COMMISSIONER

ACCOMPANIED BY:

JOHN M. WALKER, JR., ASSISTANT SECRETARY FOR ENFORCEMENT AND OPERATIONS

ALFRED R. DE ANGELUS, DEPUTY COMMISSIONER

GEORGE C. CORCORAN, JR., ASSISTANT COMMISSIONER, ENFORCEMENT

GARY KOWALCZYK, ACTING DIRECTOR, OFFICE OF PLANNING BUDGET AND PROGRAM ANALYSIS

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order.

This morning we will continue our fiscal year 1986 hearings. The Assistant Secretary of Enforcement and Operations, John Walker, and William von Raab, the Commissioner of Customs, will present the requests for the Customs Service.

Before we begin, I want the record to reflect a few problems with the fiscal year 1986 budget submission. This subcommittee has seen reductions proposed for the past 5 years. Now I have no problem with cutting bureaucracy. Administrative positions do not process cargo, passengers, or interdict contraband. People on the line do. Yet, the last 4 years the committee has been faced with restoring inspector and port specialist positions. I believe the Government is responsible to protect its borders and its citizens. That responsibility ranges from keeping fraudulent products off the shelves and keeping dangerous drugs out of

the hands of our children and keeping the Eastern bloc from gaining our technology. No matter how efficient things are, people must do the job.

Now I have heard the more with less argument a lot in the past few years. There is no doubt there are many ways and many parts of the Federal Government that should face reductions. I, however, do not think that Customs is the place. I have never been considered a big spender around here and if there is an area that is well spent, it is in the effort of the men and women who deal with Customs everyday. I have received many communications and talked with people throughout the country who state Customs is doing a fine job but it lacks the resources. If the job is going to be done, I feel the resources should be provided to the people in the trenches.

I have looked at the fiscal year 1986 budget proposal. I want it to be noted that I am not rejecting out of hand the proposals to cut down on administrative overhead. I do, however, question reduction of inspectors and import specialists. In fact, I believe we might be better served if those savings in the administrative area were added to line activities.

In any case, I want to put the subcommittee and the administration on notice that we will do a thorough review of the budget before any decisions are made.

Senator DeConcini?

Senator DECONCINI. Senator, I want to compliment the chairman for his steadfastness in attempting to be not only a responsible chairman of this committee, to keep Customs properly staffed and funded, but for your diligence in doing so, particularly when OMB and poor Customs and Treasury have to come up here and defend it. I greatly appreciate that.

I also want to thank the Commissioner for his sensitivity and attentiveness to the border problems we have faced in Arizona, most recently as a result of the assassination in Mexico of a DEA agent. I greatly appreciate that as do my constituents, Commissioner, that you have been able to work with us to preserve the security of the uniform personnel along the border and also to minimize the financial loss and burden that results from over reactions along those lines.

I, and a number of other Members of the Senate, both Democrats and Republicans, asked President Reagan about 1 month ago to have a meeting with us and members of his administration to discuss the border problems and the relations with Mexico as it relates to the Camarena assassination and murder. Unfortunately, the President elected that this was not important enough for him to visit with us. It seems when the MX and strategic defense initiative or Nicaragua or Mr. Meese come up, it is always important enough for him to see me, but when some of us want to see him about a different problem, it gets a different priority.

Notwithstanding that, because of your efforts, Mr. von Raab and Mr. De Angelus, we have been able to find some practical solutions down there, at least temporarily, and I know this Senate appreciates that immensely and we look forward to working with you.

Thank you.

Senator ABDNOR. Senate Mattingly?

Senator MATTINGLY. I have no statement at this time, but I will have questions.

Senator ABDNOR. Senate Proxmire?

Senator PROXMIRE. No statement.

Senator ABDNOR. Fine. We will call on Secretary Walker and Commissioner von Raab, whatever way you want to proceed, go ahead.

OPENING STATEMENT

Mr. WALKER. I have a brief statement I would like to present to the committee.

Mr. Chairman and members of the committee, I am very pleased to appear before you today in support of the annual appropriations request for the U.S. Customs Service for fiscal year 1986. With me are William von Raab, Commissioner of Customs. Deputy Commissioner, Al De Angelus, and other key staff members of the Customs Service who will be introduced by the Commissioner, and Mr. Gary Kowalczyk, Acting Director of the Department's Office of Planning, Budget and Program Analysis.

The fiscal year 1986 request for the U.S. Customs Service is $639,102,000 and 12,531 direct average positions for salaries and expenses and $60,425,000 for operations and maintenance of the Air Program, two separate budget items. Customs is also requesting an appropriation of $8,000,000 for the newly established forfeiture fund and $75,000 to recover anticipated reimbursements for services at small airports. The fiscal year 1986 budget for the Customs Service reflects the President's policies to control Government spending, increase operating efficiencies, maintain the effectiveness of law enforcement and responsiveness to the private sector.

The Customs Service has one of the most diverse and challenging missions in the Federal Government. It is a law enforcement agency with a critical role in enforcing our laws against the importation of narcotics, in the investigation of currency violations, in combatting commercial fraud and other trade violations, and in stemming the illegal exportation of critical technology. It is also responsible for administering this Nation's complex tariff laws which involves the collection of duties, the processing of international passenger traffic, and the overall facilitation of vast quantities of imported merchandise.

The Customs Service continues to play a vital role in the administration's effort to stop drug smuggling. Drug seizures continue to grow. Customs seized over 27,000 pounds of cocaine in fiscal year 1984. This is a sevenfold increase above the fiscal year 1981 amount of 2,741 pounds, reflecting substantial improvements in customs interdiction efforts since fiscal year 1981. I expect even greater results in fiscal year 1985–86 when we will begin to see the impact of additional equipment to enhance the Customs Air Program, which Senator DeConcini has been so active in assisting us to obtain, along with the other members of the committee.

As you know, three P–3A aircraft with detection radar are being delivered to Customs late in fiscal year 1985 in addition to various interceptor aircraft and helicopters. This equipment, when operational, should significantly advance our country's effort to suppress drug smuggling. The fiscal year 1986 Air Program budget requests an increase by one-third or $16 million over the fiscal year 1985 level in order to further strengthen this program.

ORGANIZED CRIME DRUG ENFORCEMENT TASK FORCES

Customs also contributed to our country's fight against drugs and drug-related crime through the President's organized crime drug enforcement [OCDE] task forces. Customs has played a key role since their establishment in 12 cities in fiscal year 1983. Recently a 13th task force has been added for the Miami area for which Customs has requested supplemental funding. Customs investigative work in the task forces is primarily directed to drug trafficking organizations and other forms of organized crime. This approach allows Customs to target these organizations and to exploit the financial, internal conspiracy and drug smuggling elements of their operations. In fiscal year 1984 OCDE cases involving Customs participation resulted in 727 indictments, 860 arrests, 277 convictions, $33.7 million in U.S. currency and property seizures, and the seizure of 524 pounds of cocaine and 26.4 pounds of heroin.

The Treasury Department has established within the Customs Service a Treasury Financial Law Enforcement Center to act as a clearinghouse and analytical center for financial data received under the Bank Secrecy Act. The Center provides assistance to Federal law enforcement by responding to information requests and by developing strategies for targeting criminal enterprises. During fiscal year 1984 the Law Enforcement Center identified 1,700 individuals and 500 companies who are suspected of laundering some $2 billion in drug and organized crime proceeds. A critical component of Treasury's Bank Secrecy Act Enforcement Program is the investigation of violations of the act's reporting requirements. Recently the First National Bank of Boston pleaded guilty to failing to report international cash transactions totaling $1.22 billion over 4 years. The bank was fined, after pleading guilty, $500,000 for failing to comply with the currency reporting laws.

OPERATION EXODUS

The battle against drug smugglers is only part of the Customs law enforcement mission. Under Operation Exodus, Treasury combats the illegal transfer of high technology to Eastern bloc countries. Customs goes to great lengths to detect and seize illegal exports while striving to minimize the impact on legitimate trade. In fiscal year 1984 exodus teams made 1,459 seizures of illegal goods, 258 arrests and 136 convictions were obtained.

Customs continues to emphasize Operation Tripwire, its program against commercial fraud. This effort concentrates on quota violations in connection with steel and textile imports, trademark and copyright

violations, and other forms of commercial fraud. In fiscal year 1984 Operation Tripwire accounted for 279 arrests and indictments and 1,705 seizures with a total value of over $62 million.

PASSENGER AND CARGO PROCESSING

In addition to making significant achievements in law enforcement, the Customs Service also had a busy year processing a heavy volume of traffic and trade. The Customs work force cleared 288 million people, about 90 million vehicles, vessels, and aircraft, 6.4 million formal merchandise entries, which reflects a 21-percent increase over fiscal year 1983, and more than $300 billion in cargo. Revenues collected totaled $12.5 billion.

Management and operational efficiencies are needed to process these volumes of workload. The automated commercial system [ACS] is a key effort to produce these efficiencies. It is an automated, integrated system for processing entries and performing related regulatory functions, including data collection, revenue collection, and administration of bond requirements. It will emphasize selectivity in determining which importations should receive internal examination. It will also identify those entries which have the most potential for classification changes by import specialists, resulting in increased revenue collection. Overall, the system will expedite entry processing while concentrating resources on potential problem areas. The $6.6 million to be spent on ACS will allow Customs to continue to expedite development and implementation of this system.

Wherever possible, the Customs Service must expand upon these gains in automation by centralizing functions whenever feasible and introducing new ways of doing business. For example, Customs plans to centralize its administrative functions, including accounting, payroll, personnel, and management analysis, which are currently performed throughout the Customs regional structure. Significant economies of scale are possible by centralizing such functions.

Although working within the constraints of limited resources, the U.S. Customs Service has nevertheless made significant gains in law enforcement efforts as well as processing the passengers, vehicles, and cargo that enters the country daily. I commend Commissioner von Raab and the Service for their efforts.

PREPARED STATEMENTS

Mr. Chairman, this concludes my opening statement. I will now ask the Commissioner to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the committee may have.

Thank you.

Senator ABDNOR. Before Commissioner von Raab begins we will insert your statement, Mr. Walker, along with the Commissioner's statement in the record at this point.

[The statements follow:]

STATEMENT OF JOHN M. WALKER, JR.

I am pleased to appear before your today in support of the annual appropriations request of the U.S. Customs Service for fiscal year 1986. Mr. Chairman, with me today are William von Raab, Commissioner of Customs, key staff members of the U.S. Customs Service, and Mr. Gary Kowalczyk, Acting Director of the Department's Office of Planning, Budget and Program Analysis.

The fiscal year 1986 request for the U.S. Customs Service is $639,102,000 and 12,531 direct average positions for "Salaries and Expenses", and $60,425,000 for "Operations and Maintenance" of the Air Program. Customs also is requesting an appropriation of $8,000,000 for the newly established Forfeiture Fund and $75,000 to recover anticipated reimbursements for services at small airports. The fiscal year 1986 budget for the Customs Service reflects the President's policies to control government spending, increase operating efficiencies, and maintain the effectiveness of law enforcement and responsiveness to the private sector.

The Customs Service has one of the most diverse and challenging missions in the Federal government. It is a law enforcement agency with a critical role in enforcing our laws against the importation of narcotics, in the investigation of currency violations, in combatting commercial fraud and other trade violations, and in stemming the illegal exportation of critical technology. It is also responsible for administering this nation's complex tariff laws, which involves the collection of duties, the processing of international passenger traffic, and the overall facilitation of vast quantities of imported merchandise.

The Customs Service continues to play a vital role in the Administration's effort to stop drug smuggling. Drug seizures by Customs continue to grow. Customs seized over 27,000 pounds of cocaine in FY 1984. This is a seven-fold

increase above the FY 1981 amount of 2,741 pounds, reflecting substantial improvements in Customs interdiction efforts since FY 1981. I expect even greater results in FY 1985 and FY 1986, when we will begin to see the impact of additional equipment to enhance the Customs Air Program. As you know, three P-3A aircraft with detection radars are being delivered to Customs late in FY 1985 in addition to various intercepter aircraft and helicopters. This equipment, when operational, should significantly advance our country's effort to suppress drug smuggling. The FY86 air program budget requests an increase by one-third or $16 million over the FY1985 level in order to further strengthen this program.

Customs also contributed to our country's fight against drugs and drug-related crime through its participation in the President's Organized Crime Drug Enforcement (OCDE) Task Forces. Customs has played a key role in these Task Forces since their establishment in twelve cities in FY 1983. Recently, a 13th task force has been added for the Miami area, for which Customs has requested supplemental funding. Customs investigative work in the Task Forces is primarily directed toward the financial underpinnings of drug trafficking organizations and other forms of organized crime. This approach allows Customs to target these organizations and to exploit the financial, internal conspiracy and drug smuggling elements of their operations. In FY 1984, OCDE cases involving Customs participation resulted in 727 indictments, 860 arrests, 277 convictions, $33.7 million in U.S. currency and property seizures, and the seizure of 524 pounds of cocaine and 26.4 pounds of heroin.

The Treasury Department has established within the U.S. Customs Service a Treasury Financial Law Enforcement Center to act as a clearing house and analytical center for financial data received under the Bank Secrecy Act. The Center provides assistance to Federal law enforcement by responding to information

requests and by developing strategies for targeting criminal enterprises. During FY 1984, the Treasury Financial Law Enforcement Center identified 1,700 individuals and 500 companies who are suspected of laundering some $2 billion in drug and organized crime proceeds. A critical component of Treasury's Bank Secrecy Act enforcement program is the investigation of violations of the Act's reporting requirements. Recently, the First National Bank of Boston pleaded guilty to failing to report international cash transactions totalling $1.22 billion over four years. The Bank was fined $500,000 for failing to comply with currency reporting laws.

The battle against drug smugglers is only part of the Customs law enforcement mission. Under Operation Exodus, Treasury combats the illegal transfer of high technology to Eastern-bloc countries. Customs goes to great lengths to detect and seize illegal exports while striving to minimize the impact on legitimate trade. In FY 1984 Exodus teams made 1459 seizures of illegal goods, 258 arrests and 136 convictions.

Customs continues to emphasize Operation Tripwire, its program against commercial fraud. This effort concentrates on quota violations in connection with steel and textile imports, trademark and copyright violations, and other forms of commercial fraud. In FY 1984 Operation Tripwire accounted for 279 arrests and indictments, and 1,705 seizures with a total value of over $62 million.

In addition to making significant achievements in law enforcement, the Customs Service also had a busy year processing a heavy volume of traffic and trade. The Customs workforce cleared some 288 million persons; about 90 million vehicles, vessels and aircraft; 6.4 million formal merchandise entries (which reflects a 21 percent increase over FY 1983); and more than $300 billion in cargo. Revenues collected totalled $12.5 billion.

Management and operational efficiencies are needed in order to process these volumes of workload. The Automated Commercial System, or ACS, is a key effort to produce these efficiencies. It is an automated, integrated system for processing entries and performing related regulatory functions, including data colleciton, revenue collection and administration of bond requirements. It will emphasize selectivity in determining which importations should receive internal examination. It will also identify those entries that have the most potential for classification changes by import specialists, resulting in increased revenue collection. Overall, the system will expedite entry processing while concentrating resources on potential problem areas. The $6.6 million to be spent on ACS in FY 1986 will allow Customs to continue to expedite development and implementation of this system.

Wherever possible, the Customs Service must expand upon these gains in automation by centralizing functions wherever feasible and introducing new ways of doing business. For example, Customs plans to centralize its administrative functions, including accounting, payroll, personnel, and management analysis, which are currently performed throughout the Customs Regional strucutre. Significant economics of scale are possible by centralizing such functions.

Although working within the constraints of limited resources, the U.S. Customs Service has nevertheless made significant gains in its law enforcement efforts as well as in processing the passengers, vehicles and cargo that enters the country daily. I commend them for their efforts.

Mr. Chairman, this concludes my opening statement. I will now ask the Commissioner of Customs, Mr. William von Raab, to provide you with his prepared statement, and we will then be pleased to respond to questions you or other members of the Committee may have.

STATEMENTS OF WILLIAM VON RAAB

Mr. Chairman and Members of the Committee, we appreciate this opportunity to appear before you today to present the U.S. Customs Service FY 1986 appropriation request of $639,102,000 and 12,531 direct average positions for "Salaries and Expenses" and $60,425,000 for "Operations and Maintenance" of the Air Program. Customs also is requesting appropriations for two newly established funds. The first is for $8,000,000 for a Forfeiture Fund. For the second, we are requesting $75,000 to recover anticipated reimbursements for services at small airports.

In line with President Reagan's efforts to lower the cost of government, our fiscal year 1986 "Salaries and Expenses" appropriation request is $11,586,000 less than our requested level for fiscal year 1985. We have included $14,200,000 for program initiatives, primarily for ongoing automation and communication programs, and for improving the detection effectiveness of our law enforcement officers. Our request also includes $30,609,000 for increases necessary to maintain current operating levels.

Customs' Air Program "Operations and Maintenance" appropriation request of $60,425,000 represents an increase of $16,000,000 over FY 1985. The funds will be used for program enhancements to strengthen our current and future operational capabilities.

Our objectives, as reflected in our FY 1986 budget submission, support President Reagan's precepts of strengthened law enforcement and better management of government resources. In FY 1986 we will continue our priority program to reform commercial practices through the on-going development and implementation of the Customs Automated Commercial System; a key program for decreasing processing times and reducing operational costs for both Customs and the international trade community. We are

planning to allocate an additional $6.6 million for refinements to the hardware and software components of the system.

As part of our efforts to enlist the support of private industry in this joint venture to improve the entire processing system for imported merchandise, I recently met with members of the Dallas-Fort Worth business community. I am pleased to report that Customs' program for implementing the automated commercial system and developing better procedures was well received by most business leaders. We look forward to working with business groups across the country to integrate tomorrow's technology and the most up-to-date processing procedures into the nation's cargo system.

Customs drug enforcement efforts continue to produce significant results. In fiscal 1984 the amounts of heroin and cocaine seized, again, set new records. Heroin seizures reached 664 pounds, up 12 percent over the previous year, while cocaine seizures were over 27,000 pounds, an increase of 40.4% above the previous year.

Our efforts against drug smugglers have been only a part of our law enforcement programs. To stop the illegal transfer of high-technology to Eastern-bloc countries, Customs is implementing more effective detection and investigative methods at major ports throughout the country. Customs also continues to emphasize its efforts against fraudulent imports. These efforts have produced excellent results in terms of the seizure of financial assets and prosecutions of the criminals.

The past decade has seen substantial growth in pornography trafficking. Customs is aggressively investigating pornography cases, especially where large volume dealers, organized crime, or child pornography are involved. Together with other Federal,

state, local and foreign authorities, we are working to stem the flow of importations at the source countries. As a result of Customs investigative efforts several child pornographers have been identified and arrested. In FY 1984 our intensified efforts resulted in 4,266 seizures, an increase of 122 percent.

An important part of Customs' mandate is to provide the most efficient and effective operations and management at the lowest possible cost. We are proposing to meet this objective by centralizing functions wherever feasible and introducing new ways of doing business. The initial step, to begin this year, is the centralization of virtually all administrative functions in Headquarters and the regions. The functions and staff affected are involved in strictly administrative type operations and we believe true economies are possible by centralizing these operations. To implement this centralization approach, Customs is investing some $8 million in FY 1985. As for savings, current projections are for some $5 million annually.

In FY 1986, we intend to build upon this initial major savings program by implementing organizational realignments, as well. Customs' processing and enforcement programs will be redeployed around the concept of fully operational districts staffed by a full complement of inspectors, import specialists and other enforcement officers. More efficient and effective use will be made of current staffing in low productivity ports, and, wherever possible, Customs will provide service on a cost reimbursable basis at these ports of entry. In FY 1986, Customs is projecting a net annual savings of $8,163,000 from these management efficiencies, which will be used to support the priority programs described in our budget submission.

A continuing concern of the Customs Service and the Treasury Department is the effectiveness of the Air Interdiction Program

as a deterrent against the smuggling of narcotics and contraband by private aircraft; a threat that has dramatically increased over the past several years. In FY 1984, the value of narcotics and dangerous drugs seized by the Customs Air Program was about one billion dollars. We believe the FY 1986 budget request for this program will provide Customs, for the first time, with sufficient resources to begin challenging the growing air drug smuggling problem. Included in our request is $5 million to develop a prototype air detection system and $4.6 million to increase the operational flights of the P-3As. These enhancements will enable Customs to significantly deter and disrupt the flow of narcotics into the United States.

In closing we wish to reiterate that Customs' mission is extremely important and operates in a dynamic environment, significant elements of which include the traveling public, the trade community, and American business. In fulfilling our responsibilities, we must increasingly employ sophisticated operational and enforcement techniques and a wide variety of skills and disciplines.

This concludes my introductory statement. As requested, I have submitted a more detailed statement for the record. I would be happy to answer your questions and those of the other members of the subcommittee.

Mr. Chairman and Members of the Committee, we appreciate this opportunity to appear before you today to present the U.S. Customs Service FY 1986 appropriation request of $639,102,000 and 12,531 direct average positions for "Salaries and Expenses" and $60,425,000 for "Operations and Maintenance" of the Air Program. Customs also is requesting an appropriation of $8,000,000 for the newly established Forfeiture Fund and $75,000 to recover anticipated reimbursements for services at small airports.

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Customs' "Salaries and Expenses" FY 1986 appropriation request represents a net decrease of $11,586,000 from the funds requested in FY 1985, and also includes a $17,600,000 reduction due to the proposed five percent salary reduction for all Federal employees. Included in the FY 1986 S&E authorization request is $14,200,000 for program initiatives, primarily for ongoing automation and communication programs as well as for improving the detection effectiveness of our law enforcement officers; $30,609,000 for increases necessary to maintain current operating levels; and, management efficiencies and non-recurring expenses of $44,024,000.

Customs Air Program "Operations and Maintenance" appropriation request of $60,425,000 represents an increase of $16,000,000 from the funds requested in FY 1985. Included in the requested enhancements are funds to begin a full-scale research program to develop an operational 360 degree radar for use on detection aircraft; modification of C-12 aircraft; additional flight hours for the four operational P-3A aircraft; and, operation of two additional Blackhawk helicopters. The appropriation request also includes $5,000,000 for annualization of current year approved operations and non-recurring costs of $5,000,000.

MAJOR ACCOMPLISHMENTS

The Customs Service, once the main source of federal monies, still continues today to collect significant revenues as well as to assume the responsibility for interdicting illegal attempts to bring drugs and other contraband into the country. Although the primary objective of the Tariff Act is the protection of American industry, revenue collections from its enforcement produced $12.5 billion in FY 1984, and is projected to reach $15.0 billion in FY 1986.

As usual, Customs also had a busy year processing a heavy volume of traffic and trade generated by a growing international economy. The Customs workforce cleared some 288 million persons, 6.4 million merchandise entries, up 21 percent, and more than $300 billion in cargo entering the country. In addition, about 90 million vehicles, vessels, and aircraft were processed. Projections for FY 1986 indicate continued growth and a heavy workload in the future.

Management efficiencies Customs is implementing in FY 1985, and those to be achieved in FY 1986, represent improvements in administrative, commercial and enforcement activities as well as updated approaches for achieving Customs' mission. These programs, when fully developed and implemented, will improve productivity, streamline program operations, enhance organizational and functional efficiency, and abolish duplicative activities. Many of the efficiencies result from our efforts to convert labor intensive functions to more automated processing. In total, these actions will produce savings of 887 average positions and provide substantial savings in future years.

As I stated on previous occasions, Customs will adhere to President Reagan's precepts of strengthened law enforcement and better management of government resources. Our objectives in FY 1986 are to achieve the following:

- Improved enforcement efforts to combat those illegal activities that fall within Customs' jurisdiction by the introduction of the most effective techniques;

- Increased staff productivity by developing and implementing automated systems, wherever possible, in all merchandise, revenue collection, and enforcement processing; and,

- Efficiencies in administration by centralizing functions, eliminating duplicative activities and unneeded paperwork, and simplifying processing procedures.

Customs' efforts directed toward stengthening law enforcement programs produced significant results in FY 1984. Smuggling continues as a significant national problem. We are still confronted with an illegal industry of billions of dollars and continual smuggling along all our borders.

But I do have good news to report. Through the combined efforts of Customs and the Coast Guard marihuana seizures rose by 19.4 percent, probably reflecting increased "mother" ship and air smuggling operations. Customs' heroin and cocaine interceptions have set new records. Heroin seizures in FY 1984 reached 664 pounds, up 12 percent from the previous year. The results largely reflect intensified inspections at airports, especially cargo, and the use of improved inspectional techniques.

With regard to cocaine, I must commend Customs enforcement groups for the outstanding results produced during the past four years. In FY 1982, we seized 11,150 pounds of cocaine, an increase of more than 200 percent above the previous year. In FY 1983, seizures reached 19,602 pounds, more than 400 percent above FY 1981 and 76 percent over FY 1982. In FY 1984, seizures were again significantly higher, reaching 27,525 pounds, for an increase of 40.4 percent above the previous year and a sevenfold increase above the FY 1981 amount of 3,741 pounds. In FY 1984 we disrupted organized smuggling groups by taking about $7.5 billion in cocaine sales off the streets and preventing the criminals from pocketing the profits. And, for the first quarter of FY 1985, Customs cocaine seizures are continuing at a rate of more than double the record fiscal year 1984 total.

These results, of course, largely reflect the high priority

of Customs law enforcement. The nation faces two major problems at its borders. The first is massive drug smuggling, which has been with us for at least a generation and is now one of our major industries. Customs has responded by continuing its successful enforcement efforts in South Florida, along the Southwest border, and at major airports, where the major share of illegal narcotics activity is centered. In South Florida, huge sums of drug-related currency enter and leave the country daily to finance this deadly international traffic.

The second problem is critical technology illegally leaving the country. In line with President Reagan's call to stop the illegal transfer of high-technology to Eastern-bloc countries, Customs is continuing Operation EXODUS. Furthermore, we are implementing more effective detection and investigative efforts at major ports throughout the country. To achieve this goal, Customs has developed new approaches for surveillances; improved cargo inspections directed at uncovering these illegal equipment shipments; and, improved intelligence efforts related to shipments and potential violators.

While the enforcement effort is now well on its way to achieving its objectives, Customs Service goals also include facilitation, and the reduction of the costs to the public and to the Government, of the processing of international trade. Facilitation of passenger and cargo processing is a high priority. We do not believe that every passenger, vehicle, piece of baggage, or cargo shipment must be searched. Since the vast majority of Customs transactions involve law-abiding persons and firms, Customs officers are directing their primary attention to "high-risk" passengers and cargo. It is clear to me that effective enforcement and efficient facilitation can go hand-in-hand, without contradiction or without diminishing our law enforcement.

Customs also is continuing its priority program to reform commercial practices; in essence, how we implement the tariff laws and how we process the vast quantity of imported merchandise. In meeting our goals in commercial processing, we are pushing forward determinedly with "consolidation", "automation" and "streamlining" of all applicable operations.

Simplification of forms, paperwork, and procedures will reinforce automation and help to speed up the cargo clearance process. A major project consolidating our data processing functions into a single computer environment has been completed. We feel that this will eventually permit us to dramatically improve Customs processing of imports and to implement new methods of collecting duties.

At the heart of the automation effort, is the Automated Commercial System (ACS). Today, at numerous ports, we have on-line a comprehensive data base with all the functions required for processing electronically transmitted or manually prepared entries. Therefore, the system can efficiently process any and all entries prepared by all the brokers. All revenue collected by Customs is processed through ACS, as is the preparation of a daily broker statement. Also, the system is being integrated in the operations of local port authorities and major importers. The whole importing community is cooperating in its implementation. Supplementary systems for processing Fines, Penalties, and Forfeitures (FP&F) and Bonded Warehouse Inventory (BWICS) are being completed. In summary, ACS comprises ten separate stand alone modules specifically directed to each of the major activities under the commercial system. Many of these systems are already in full operation. When fully developed and implemented the system will provide improved management information, more efficient resource use, and increased responsiveness to the business community.

FY 1986 Plans

In FY 1985, Customs is planning its expansion and development of ACS and its telecommunication system as well as developing an up-to-date TECS system, applicable for today's enforcement environment.

Automated Commercial Systems

The $6.6 million to be spent in FY 1986 will allow Customs to continue to expedite development and implementation of the full system needed to raise productivity and continue efficient service as the workload grows. When completed, ACS will support full selectivity, determining which imports should be intensively examined and those entries with potential classification changes and increased revenue. This enhancement will pay for itself in cost savings for Customs and the importing community. In FY 1986, system development and hardware expansion for the following modules will be implemented: manifest processing, quota, account billing, fines, penalties and forfeitures, and the Customs information exchange.

Integrated Data Telecommunications Network

Currently, Customs has two independent telecommunications systems: one supports the Treasury Enforcement Communications System (TECS) by providing essential information to support enforcement activities; and, the other supports the Commercial and Administrative Systems associated with revenue processing. Since these networks were designed and developed separately, at different times with different missions in mind, they are incompatible for many important functions. In addition, both use technology that is now obsolete. While updating both systems to incorporate the latest technology, Customs will also

consolidate both networks reducing redundant costs and improving operations. Customs is planning to build upon the funding provided in FY 1985 by reallocating an additional $2.8 million to complete the project. These funds will be used for modern telecommunications equipment such as mini-computers, packet switching equipment, telecommunication circuits and earth station antennas.

TECS II Development

The thrust of TECS II Design and Development is to build a comprehensive enforcement data base system whose underpinnings are state-of-the-art hardware, software and data base management systems. All current TECS users will contribute their expertise to the design of TECS II and will, therefore, have firsthand experience with TECS II as it evolves. This system will provide for the expansion and integration of the existing automated enforcement efforts such as Operation EXODUS, the Treasury Financial Law Enforcement System and commercial fraud, as well as other enforcement efforts. This initiative will afford Customs the flexibility to meet the numerous information requirements of today's Customs enforcement program. The $4.0 million investment will provide upgraded assistance and support to the ten enforcement agencies in and outside Treasury using the system.

Proposed Management Efficiencies

As stated in my previous appearances before this Subcommittee, other Congressional groups, and business and industry groups, I believe an important part of my mandate as Commissioner of Customs is to bring to Customs the most efficient and effective operations and management possible at the lowest possible cost. At this time, when the entire federal budget must be closely monitored to eliminate excessive and

duplicative costs, and significant budgetary reductions are required, as this Subcommittee is well aware, this goal becomes the highest priority for all agency managers. I believe Customs is no exception and must shoulder its full share of the cutbacks.

For this year and in FY 1986, I am proposing to meet this objective by expanding upon our gains in automation by centralizing functions wherever feasible and, most importantly, introducing "new ways of doing business". The initial step in the proposed series of initiatives is the centralization of virtually all administrative functions within Customs, which will be started and completed during FY 1985. What do we mean by centralization of administrative functions? Currently, the accounting, payroll, personnel, management analysis, etc., functions are spread throughout Customs; there is a large Headquarters component for each activity and related functional groups in each of the Regional offices. The functions and staff involved are not operational in nature and do not function in the ports or districts; these are strictly Headquarters administrative type operations.

Since the processing and recordkeeping of these functions are generally computer generated, our studies indicate that true economies of scale are possible by centralizing these operations. As now planned, the operations and assigned positions will be transferred to Indianapolis, Indiana, and Washington, D.C., to carry out all of Customs' administrative functions. To implement this centralization approach, Customs is investing some $8 million in FY 1985. As for savings, current projections are for some $5 million annually.

In FY 1986, we intend to build upon this initial major savings program by implementing organizational realignments, as

well. Customs' processing and enforcement programs will be redeployed around the concept of fully operational districts. Customs' laboratories will operate at possibly two locations. Each district will be staffed by a full complement of inspectors, import specialists, and other enforcement agents. Entries will continue to be filed as previously, but the actual processing will be at the appropriate district office. Also, more efficient and effective use will be made of current staffing in low productivity inland ports, seaports, northern and southern border ports. Wherever possible, Customs will provide service on a cost reimbursable basis at these ports of entry.

In FY 1986, Customs is projecting a net annual savings of $8,163,000 from these management efficiencies, which will be used to support the priority programs described in our budget submission. In the out years, we are projecting annual savings of some $29 million.

REPORT ON CUSTOMS ENFORCEMENT AND OPERATIONAL PROGRAMS

INSPECTION AND CONTROL

Customs' Inspection and Control program processes persons and cargo, and clears carriers, for both revenue and enforcement purposes. Customs' efforts to improve enforcement of pertinent laws and regulations and expedite processing of persons and goods will continue in FY 1986. Our objective, despite resource constraints, is to achieve a balance of economical processing while still maintaining full service.

Customs will continue to meet the challenge of a growing workload while improving overall effectiveness through the expanded utilization of automated systems, selectivity systems and other innovative techniques. Increasingly selective and automated inspectional techniques will enable Customs inspectors to concentrate their efforts on the "high-risk" passengers and

cargo while allowing the predominantly law-abiding transactions to receive minimal attention. We will continue to streamline cargo processing through the use of automated technology that will improve our ability to facilitate the entry of merchandise without weakening our enforcement posture. Our enforcement efforts will be enhanced through the use of fully implemented selectivity systems. Our special teams of inspectors, equipped with detector dogs and the best possible intelligence we can provide will continue to concentrate on high-risk cargo. These teams have already established significant cost-benefit ratios with noteworthy narcotics seizures from cargo and baggage. We will expand their use, increase their expertise, and improve the equipment available to them to achieve even more significant results in FY 1986.

Passenger Processing

As in previous years, Customs processed approximately 290 million persons entering the United States, of which 31 million were air passengers. Although air passengers constitute approximately 10 percent of the total number of persons entering the country, they require a disproportionately large share of Customs resources due to the limited facilities available and the substantial crowding during processing. The problem is intensified because flight arrivals at airports are concentrated within certain time periods and the expansion of facilities to meet the growing workload is minimal.

To meet these greater demands and insure that its workload is efficiently facilitated while full enforcement is maintained, Customs has developed and implemented new higher speed processing systems tailored to accommodate the physical configuration and threat level of each airport. These processing systems allow the rapid processing of law-abiding travelers and the more efficient detection of suspected violators.

One of our major initiatives for FY 1986 will be regulatory changes to private aircraft and small boat reporting procedures. Under the proposed rulemaking, reporting requirements for private aircraft considered as a high risk will be made more stringent, and detailed justifications will be required for overflight exemptions. In addition, more stringent reporting requirements are being considered for small boats.

The enforcement aspects of passenger processing are being reinforced by the use of inspectors trained in new observational techniques, development of walk-through narcotic detection devices, passport "readers", and fiber optics inspection devices for more quickly inspecting inaccessible areas in aircrafts and other vehicles. During the 1984 Summer Olympic Games in Los Angeles some of these new techniques were available for our use in handling the special security and visitor processing responsibilities and proved very successful. In FY 1986, Customs will be spending $300,000 to acquire 57 fiber optics devices which will be deployed to critical smuggling locations.

Cargo Processing

Customs is continuing to streamline its efforts in the cargo processing area. These efforts are aimed at facilitating the flow of legitimate cargo through our air and sea ports while focusing emphasis on suspect shipments. In order to speed the flow of merchandise, we are expanding existing cargo selectivity and enhancing our automated cargo processing systems. The most significant innovation has been the expanded and enhanced Automated Cargo Clearance and Enforcement Processing Techniques (ACCEPT) system. Rigorous system testing showed that regulatory and enforcement efforts could be improved and cargo expedited by intensively examining only selected shipments identified by automated intelligence as high risk. Customs ACCEPT is now in

operation at 31 major ports, and 11 additional sites will be implemented in FY 1985. The entire processing and inspection operation is directed by a central-site computer. At the same time, a manual version of the system, previously developed for use at small to medium-sized ports, will be installed at additional locations. The enforcement aspect of ACCEPT was also strengthened by integrating it with the Customs Automated Cargo Transaction Intelligence System (CACTIS), which provides background data on each shipment.

In the future, ACCEPT is to be incorporated into the Automated Commercial System, which will control processing of cargo from its arrival at the docks or airports until release to the importer. Until that system is fully operational, expansion of ACCEPT as a stand alone system will continue at major ports.

Contraband Enforcement Teams

Contraband Enforcement Teams (CET) are reinforcing traditional inspectional operations. These teams gather and disseminate intelligence, perform input document review, and analyze and search suspect cargo. Whenever violations are detected, the merchandise, drugs, contraband, and items in violation of currency reporting and export laws are seized. CET capabilities will be bolstered by combining their search efforts for drugs in cargo with those of the Canine Teams. As a result of improved intelligence gathering and dissemination, the CET teams in the future will be capable of more specific targeting of potential illegal activities, which we believe will result in more significant seizures.

Tariff and Trade Program

The Tariff and Trade Program is responsible for appraisement, classification, duty assessment and collection on

entries of imported merchandise, as mandated in the Tariff Act of 1930. Related and equally important functions include verification of import statistics; administering national trade policy by monitoring quotas, steel import restrictions, and various trade agreements; and enforcing merchandise admissibility for over 40 other Federal agencies and 400 related laws.

Improvements in the complete range of tariff and trade operations are continuing and an in-depth review of the merchandise processing system is underway. Our goal is to reduce the burden on the importer, especially the costs of doing business with Customs, while insuring that Customs maintains required services, even with increased merchandise imports. I am pleased to report that development projects begun in FY 1983 became operational early in FY 1984. A brief description of these innovations is included to provide you with some insight into the new business methods Customs has implemented.

Automated Commercial System

Efforts to automate Commercial operations are continuing with the implementation of additional Automated Commercial System (ACS) Modules, including bonds, manifest processing, entry selectivity, and interest on bills. ADP equipment linking field operations to the national computer and an automated interface with importers, carriers, and other agencies will be implemented.

ACS is now processing merchandise entries, revenue collections, entry liquidations, and an increasing number of broker transactions. On the commercial side, ACS is selectively directing inspectors to merchandise requiring examination and import specialists to merchandise requiring classification or

value changes. As foreign trade rises, proper inspection, examination valuation, and classification are needed to ensure that all duties are collected. In FY 1986, $6.6 million will be used to develop an integrated data base, permitting more timely and accurate management information, and increased employee productivity. Refinements to hardware and software components will be implemented and the following modules will be developed: manifest processing, quota, in-bond, fines, penalties and forfeiture, and the Customs Information Exchange.

Automated interface with broker, importer and port authority computers is a key feature of the system. Currently, a substantial percentage of the entry summaries presented to Customs are prepared on broker computers, and that number is expected to grow by 1986. Customs views this as a unique opportunity for both the trade and Customs to work together.

Selectivity criteria, which also is important for both cargo examination and import specialist review, will be maintained in a unified data base. The system, when fully operational, will be capable of identifying the types of review required by the import specialist. As is common in this type of processing, random sampling will maintain system integrity.

Tariff and Trade Program participation in Customs' overall enforcement effort includes the final operational testing of the wind tunnel narcotics detector and the expansion of import specialists' role in fraud teams, special analytical teams and assessment of penalty cases. Of particular interest, the laboratory is supporting the Fraud Program by increased sampling analyses and through the use of sophisticated technology. This has increased not only the revenue collected but also the collection of fines and forfeiture actions. In FY 1986, Customs will be purchasing and installing 10 wind tunnels (Narcotic

Detection Systems) at major airports. The cost is $500,000. To provide full coverage at all airports, 200 wind tunnels would be required.

These innovations, and perhaps others, will pay increasing benefits in the future and will be the means for eliminating unnecessary paperwork, simplifying processing methods, and, best of all, making the importation of goods and payments of duties a more businesslike operation.

Air Program

A primary concern of the Customs Service and the Treasury Department has been the effectiveness of the Air Interdiction Program as a deterrent against the smuggling of narcotics and contraband by private aircraft, a threat that has dramatically increased over the past several years. In FY 1984, the value of narcotics and dangerous drugs seized in the Customs Air Program was about one billion dollars.

In an effort to most effectively respond to this serious problem, Customs air operations have adopted a strategy of concentrating air personnel and equipment in high-threat areas and using them in conformance with the detection, interception, and tracking methods developed specifically for the interdiction operations confronting Customs air units. Air operations use strategic and tactical intelligence for selecting optimum times and places for deploying interdiction units. Detection systems identify suspect aircraft and direct apprehension helicopters and ground support units to the precise location to capture smugglers.

In FY 1986, Customs is requesting $60,425,000 for Air Program operations and maintenance, an increase of $16.0 million

over FY 1985. I believe this budget will provide Customs, for the first time, with sufficient resources to begin challenging the growing air drug smuggling problem.

The capabilities of Customs air units will be greatly enhanced in FY 1986. Each unit will include high-speed jet interceptors equipped with radar and Infrared Detection Systems, long-range tracker aircraft, high performance helicopters, and single and multi-engine support aircraft.

The program is dependent upon effective detection of smuggler aircraft. Currently, we use airborne and land-based radar to track smugglers and guide our own aircraft. The funding for FY 1986 will support a stationary radar-equipped Aerostat in the Bahamas, which will greatly expand our detection coverage. In addition, four fully equipped P-3A aircraft will be operating along the Southern border.

Customs also has enhanced its effectiveness to respond to the anticipated increase in smuggler detection. Implementation of strong centralized management of the program and establishment of east and west Regional Operations Control Centers have resulted in better control and flexibility in responding to the shifting smuggling threat. A full complement of tracker/interceptor aircraft will be acquired in FY 1985, and all will be fully operational in FY 1986. In support of these operations, Customs will increase its high-speed helicopter fleet for more effective apprehensions.

The additional $16.0 million requested for FY 1986 will enhance Customs' current and future operational capabilities. Based on a detailed study of our detection capabilities, Customs is requesting $5 million to develop a prototype air detection system centered around a 360 degree radar with a requirement for

detection of up to a five meter target at a range of 100 miles. This system will certainly increase the detection capabilities of appropriate long-range aircraft. Furthermore, an additional $4,600,000 is requested for extending the operational flights of the P-3As, which will increase smuggler detection. Two other enhancements are: $5,000,000 for modification of the C-12 aircraft to be transferred from DOD; and, $1,400,000 for operation of two new Blackhawk helicopters acquired by Customs.

Marine Program

In conjunction with the Air Program, Customs Marine Program protects the sea approaches to the nation's borders. Confronted with similar growth in its smuggling problem, the program now has 118 operational vessels, ranging in size from 15 to 60 feet, stationed at 60 locations. Also, Customs' newly developed operational approach includes ten marine modules, all of which will be operating by the end of FY 1985. These vessels are used for surveillances, waterside raids, intelligence gathering, and interdiction. Today's interdiction units confront large-scale smugglers using "motherships", stashes on off-shore islands and "air drops". Recent seizures indicate that major smuggling by vessel is still active in the Southeast and Gulf Coast and is increasing along the Pacific, Mid-Atlantic and New England coastal areas.

To counter the threat of smuggling by private and fishing vessels, the successfully tested Marine Enforcement Modules will be stationed in ten critical smuggling locations. Each module will consist of specially trained personnel and state-of-the-art marine equipment. Each team will be responsible for developing tactical information on smuggling in its local area and for interdicting marine smugglers. In addition, in order to combat smuggling at major seaports, Customs officers will develop

information targeting specific persons, groups and vessels and conduct intensive vessel searches to locate concealed narcotics.

Customs established two marine enforcement modules in FY 1984 with existing resources and made maximum use of seized and forfeited vessels to equip the modules. Exchange/sales were used to obtain the high-speed interceptor boats needed. Information developed through the module contributes to a more reliable and responsive intelligence network and results in more arrests and seizures of contraband. We anticipate establishing additional marine modules. One will be located in New York and others are planned for Key West, Miami, Key Largo, West Palm Beach, Galveston, and New Orleans. Establishment of these marine modules will greatly improve our enforcement results, significantly increasing seizures and arrests.

Investigations

The Customs Service investigates violations of Customs and related laws. Included under this broad mandate are currency, fraud, export and international enforcement. In each program targeting depends heavily upon the development and collection of intelligence. In accomplishing these investigative tasks, during the past year, several major enforcement objectives were emphasized.

Organized Crime Drug Enforcement (OCDE)

Presidential Drug Task Forces were established in FY 1983 and are now located throughout the country. Customs participates with other Federal law enforcement agencies in these task forces. The financial investigations focus on smuggling groups responsible for the laundering of large sums of money. We believe this program is a major step in assuring the success of

the President's goal of disrupting organized crime throughout the country.

During FY 1985, the task forces are expanding to include Miami, the 13th core city. Customs is requesting $2.2 million in supplementary funds to deploy 30 Special Agents and required support in Miami. Our experience indicates that this task force will produce significant results against large-scale smuggling groups operating in the area.

In FY 1986, Customs plans to continue with current commitments of resources to the Presidential Organized Crime Drug Enforcement Task Forces. These specialized investigative task forces focus on large-scale drug smuggling organizations, approach each target and simultaneously exploit the financial, internal conspiracy and interdiction/smuggling elements of each criminal organization. To date they have achieved excellent results. In FY 1984, cases involving Customs participation resulted in 727 indictments, 860 arrests; 277 convictions; $33.7 million in U.S. currency and property seizures; and, seizures of 524 pounds of cocaine and 26.4 pounds of heroin.

Fraud Program

For several years, Customs has emphasized its fraud efforts against unauthorized steel, textile, wearing apparel imports, drawback, and trademark and copyright violations. These efforts have produced excellent results in terms of financial gains and prosecutions of criminals. Also, domestic industry and jobs were protected from unfair and illegal international trade practices. In FY 1984 Operation Tripwire, which is the designation of our special emphasis against fraudulent imports, accounted for 279 arrests and indictments, and 1,705 seizures with a total value of over $62 million.

In terms of specific cases, Customs' emphasis on commercial fraud investigations has produced promising results. A typical case concerned a New York coffee broker who, after being confronted with an intensive Customs investigation, decided to settle a criminal and civil suit involving false entry of coffee from Central America. The case resulted in a $3.3 million gain for the U.S. Treasury.

As reported for the past several years, Customs is looking very carefully at all steel imports. In a recent case, this paid off in 11 indictments for overvaluation and circumventing the Trigger Price Mechanism. Our intensive inspections and investigations of fraudulent textile imports have produced 106 seizures, valued at over $9 million so far in fiscal year 1985.

Based on past accomplishments, task force operations in FY 1985 will continue to direct their efforts against illegal merchandise before it enters United States commerce and to investigate cases arising during intensified inspections. The task forces will focus on high risk importations at major ports to assure continued high quality arrests and major revenue recoveries, and to present a visible deterrent. In addition, the Fraud Investigations Center will be steadily expanded to improve data acquisition, intelligence analysis targeting and trend analysis.

A significant improvement in Customs' effectiveness will occur when the expanded capability to target violators, by correlating commercial, financial, and economic data using ADP systems within selected "high-risk" areas, is implemented. To this end, we are using integrated functional teams in high-activity areas to obtain intelligence and enforcement effectiveness.

Financial Law Enforcement Program

Our investigative attack on criminal organizations under provisions of the Bank Secrecy Act and through their financial transactions has paid excellent dividends in terms of its impact on the largest smuggling groups operating in this country. Multi-agency investigative and prosecutorial teams, operating under the leadership of the local U.S. Attorney, are currently active in cities with large-scale currency movements and in those cities at the forefront of top-level drug trafficking and money laundering.

Our Financial Law Enforcement Center (FLEC) is the clearing house for all financial data. The Center analyzes the financial characteristics of criminal markets and assists in developing useable strategies for exploiting criminal financial business practices. Needless to say, the Center is also the source of intelligence, both domestic and foreign, developed and adapted for the investigative field units. During FY 1984 FLEC conducted analyses which identified 2,400 individuals and 700 organizational entities suspected of laundering some $2 billion.

Operation EXODUS

Operation EXODUS combats illegal exports or equipment, computer parts, classified defense items, and lasers. In addition, and equally serious, is the illegal transfer of technical data on research, development, and manufacturing. Our job is not only to detect these shipments, but also to punish the individual violators. Ultimately, if we are to be successful, we must discourage the activities of the manufacturers, overseas intermediaries, and foreign operatives. I am pleased to report that we are receiving the strong support of American industry in this effort.

Customs' efforts in this program in FY 1985 will focus on targeting illegal exports while minimizing the impact on legitimate trade. Expanded use of specifically targeted enforcement operations concentrating on highly selective critical exports, increased foreign information, and ADP generated analytical intelligence are critical factors for improving overall effectiveness.

In FY 1984, EXODUS teams located at major ports made 1,459 seizures. Subsequently, 663 major investigations were accepted for prosecution; and Customs officers were responsible for 354 indictments, 258 arrests and 136 convictions throughout the year. In FY 1986, a wide range of enforcement initiatives will be implemented: additional covert operations; an expanded munitions control program; enhanced liaison with the intelligence community; increased foreign cooperation; and, support and assistance to foreign governments in their own conduct of covert operations directed against EXODUS violations.

Pornography

The past decade has seen substantial growth in pornography trafficking. Customs has characterized pornography as a problem of prime concern and has stepped up the level of enforcement in this area. We are aggressively investigating pornography cases, especially where large volume dealers, organized crime, or child pornography are involved. Since pornography is smuggled into the United States chiefly through the mails, we have a vital role in curbing the importation of pornographic materials and seeking prosecution of violators of Customs and related laws. To accomplish this, Customs, together with other Federal, state, local and foreign authorities, is working to stem the flow of importation at the source countries. As a result of Customs' investigative efforts several child pornographers have been

identified and arrested. In FY 1984 our intensified efforts resulted in 4,266 seizures, an increase of 122 percent above the FY 1983 total of 1,918 seizures.

Conclusion

In closing, we wish to reiterate that our basic mission is the collection of revenue and enforcement of Customs and related laws. Our mission is important and operates in a dynamic environment, significant elements of which include the traveling public, the trade community, American business and the general public. Customs, in fulfilling its responsibilities, must increasingly employ sophisticated operational and enforcement techniques and a wide variety of skills and disciplines.

In FY 1985, Customs will continue its reform in commercial merchandise processing as well as expand on its administrative improvements. Wherever possible, selective approaches supported by automation and reduced procedural requirements will be implemented. In each case, we are attempting to speed up the processing times. As described earlier, we will be working closely with the importing community to insure that the planned operating system meets their needs as well as our own. Similarly, we will be introducing more efficient administrative support throughout Customs, particularly for operational programs. There is an ongoing review of all administrative functions in order to eliminate excessive overhead and duplicative activities.

Today, I have outlined a blueprint of recent improvements and future directions. In FY 1986, we should begin to see the results of these efforts as many of the innovations become fully operational.

This concludes my introductory statement. We are available to discuss the details of the request and answer your questions and those of the Subcommittee Members.

CUSTOMS AUTOMATED COMMERCIAL SYSTEM

Mr. VON RAAB. As always, it is a pleasure to appear before this committee. I have a detailed statement that I would like to submit for the record and make some brief remarks and then answer your questions. Is that acceptable?

As Mr. Walker indicated, our objectives as reflected in our fiscal year 1986 budget support President Reagan's precepts of strengthened law enforcement and better management of Government resources. In fiscal year 1986, we will continue our priority program to reform commercial practices through the ongoing development and implementation of the Customs automated commercial system, a key program for decreasing processing times and reducing operational costs for both Customs and the international trading community. We are planning to allocate an additional $6.6 million for refinements to the hardware and software components of the system.

As part of our efforts to enlist the support of private industry in this joint venture to improve the entire processing system for imported merchandise, I am pleased to tell you we have had tremendous response from the business community. I am also pleased to report that Customs' program for implementing the automated commercial system and developing better procedures has been well received by all of the business leaders. We look forward to working with business leaders to integrate tomorrow's technology and the most up-to-date processing procedures into the Nation's cargo system.

ENFORCEMENT EFFORTS

Customs drug enforcement efforts continue to produce significant results. In fiscal year 1984 the amounts of heroin and cocaine seized, again, set new records. Heroin seizures reached 664 pounds, up 12 percent over the previous year, while cocaine seizures were over 27,000 pounds, an increase of 40.4 percent above the previous year. I might add, this year, particularly in the area of cocaine interdiction, we are seeing even greater increases.

Our efforts against drug smugglers have been only a part of our law enforcement programs. To stop the illegal transfer of high technology to Eastern bloc countries, Customs is implementing more effective detection at the major airports and ports throughout the country. Customs also continues to emphasize its efforts against fraudulent imports. These efforts have produced excellent results in terms of the seizures of financial assets and prosecution of the criminals.

This past decade has seen substantial growth in pornography trafficking. Customs is aggressively investigating pornography cases, especially where large volume dealers, organized crime, or child pornography are involved. Together with other Federal, State, local, and foreign authorities we are working to stem the flow of importations at the source countries. As a result of Customs' investigative efforts, several child pornographers have been identified and arrested. In fiscal year 1984 our intensified efforts resulted in over 4,000 seizures, an increase of 122 percent.

An important part of Customs' mandate is to provide the most efficient and effective operations and management at the lowest possible cost. I know in the questions you will have we will examine in more detail what proposals the Customs has to effect this effort.

AIR INTERDICTION PROGRAM

A continuing concern of the Customs Service and the Treasury Department is the effectiveness of the Air Interdiction Program as a deterrent against the smuggling of narcotics and contraband by private aircraft; a threat that has dramatically increased over the past several years. In fiscal year 1984 the value of narcotics and dangerous drugs seized was about $1 billion. We believe that the fiscal year 1986 budget request for this program will provide Customs for the first time with sufficient resources to begin challenging the growing air drug smuggling problem. Included in our request is $5 million to develop a prototype air detection system and $4.6 million to increase the operational flights of the P-3A's. These enhancements will enable Customs to significantly deter and disrupt the flow of narcotics into the United States.

In closing we wish to reiterate that Customs' mission is extremely important and operates in a dynamic environment, significant elements of which include the traveling public, the trade community and American business. In fulfilling our responsibilities, we must increasingly employ sophisticated operational and enforcement techniques and a wide variety of skills and disciplines.

This concludes my introductory statement.

I would now be happy to answer any questions you have.

PERSONNEL ASSIGNMENTS

Senator DECONCINI [presiding]. With the chairman's absence, I will take the prerogative of asking a few questions and then yield to the Senator from Georgia.

On December 13 Chairman Abdnor and I wrote then Secretary Regan requesting information on how Treasury was doing in complying with various committee directives contained in Senate Report 98-562. Around the first week of March you wrote us back and said you were unable to comply with about eight provisions. One of those was your inability to comply with our directive to assign additional employees to relieve the congestion at the border in Nogales and an unwillingness to fill an import specialist position in Phoenix, a position that would make all of the difference in the world to those businesses in our State.

I know you have a tight budget but can you tell me for the record why you did not put more people on at Nogales and fill the import specialist post in Phoenix?

Mr. VON RAAB. The Customs Service has been operating under an absolute freeze for all of its hires, not only new hires but actually filling old slots since December 26, and I personally review every single request to hire an individual. I do not review the individual's personnel background, but I do review the request to fill a specific position in a

specific area of the country. The demands on Customs' resources and the range of Customs' priorities have been such that I have found it necessary to fill those positions that specifically support law enforcement or, in the case of the trade programs, to fill positions in the most critical areas. The positions you have described were not filled since they did not meet one of these two conditions.

As we work through the year, we will certainly try our best to address those issues. However, I must say, until we know what our fiscal year 1986 budget is, we must continue to operate very, very strictly.

Senator DECONCINI. Commissioner Nelson spoke at a recent hearing and said under the same language directive he was able to find some part-time assignments which was better than none at all. I wondered if that was considered by you?

Mr. VON RAAB. No, that wasn't. Maybe I should have considered that and I will be happy to look at that. As you are probably aware, our concern is hiring up, as we go into 1986, because the fiscal year 1986 budget does reflect reductions in the Customs Service. We do not want to step into October 1986 having hired individuals who would then subsequently have to be moved around the Customs Service.

PORT OF PHOENIX

Senator DECONCINI. I can appreciate that. I guess what you are saying is if you really want us to do it, there is no use putting it into the language, put it into the law.

You seem to have singled out Phoenix as a freestanding port of entry. You plan to take away Phoenix's appraisement function and consolidate the port of Phoenix into Nogales. What rationale could you use for taking that action next year and why would this function be consolidated into Nogales?

Mr. VON RAAB. I will ask Mr. De Angelus to answer. We are not singling out Phoenix. Phoenix is part of a larger plan to consolidate local districts and appraisement centers.

Mr. DE ANGELUS. Senator, with the implementation of our automated system, import specialists are no longer required at every port of entry. Our proposals in no way affect the movement of people or cargo and we will continue to use Phoenix as a point of entry. However, we believe it is a more efficient use of our tax dollars to centralize our import specialists at major cargo entry points around the United States and under the proposals for consideration, there would only be one import specialist processing district and for Arizona that would be Nogales.

Senator DECONCINI. Does that mean Phoenix would not be considered a port of entry?

Mr. DE ANGELUS. Yes; it would still be a port of entry, but the paperwork would be done in Nogales.

Senator DECONCINI. The merchandise that comes through Phoenix could be cleared but the administrative paperwork after the clearance and disposition of the merchandise or whatever is coming in, the administrative paperwork would be done in Nogales. Is that what you are telling me?

Mr. DE ANGELUS. Correct.

Senator DECONCINI. Customs' original budget was $609.5 million and 13,000 slots and Treasury cut you back 638 positions. Then OMB cut you even deeper to your pending request of $639,102,000 and 12,531 positions, about 830 less than Treasury allowed. In your budget justification accompanying your OMB submission, you say: "With 12,866 positions—350 more than you got—enforcement results may be jeopardized." I want to provide for the record, Mr. Chairman, an evaluation of the number of Customs employees, valued imports in billions of dollars; populations of countries and the square miles of the United States, compared to Australia, Canada, Germany, France, Japan, and the United Kingdom. The United States is far under, in number of Customs personnel and far greater in the number of dollars of imports, population, and in square miles. I would like to submit this chart for the record which points out the United States has only 13,400 Customs employees with a value of imports of $362.2 billion, a population of 229 million, and square miles of over 3,618,000, whereas the Federal Republic of Germany has 33,000 Customs employees, $153.5 billion of imports, 62 million people and only 96,000 square miles. I would like to submit this for the record.

Senator ABDNOR. Without objection.

[The information follows:]

Country	Number Customs employees	Value imports (billion)	Population (million)	Area square miles
United States	13,400	362.2	229	3,618,000
Australia	4,950	20.4	15	2,966,000
Canada	8,000	71.3	25	3,831,000
Federal Republic of Germany	33,000	153.5	62	96,000
France	22,000	100.1	54	211,000
Japan	8,000	124	119	146,000
United Kingdom	25,000	98	56	94,000

ENFORCEMENT PROBLEMS

Senator DECONCINI. I would like to ask a few more questions. If enforcement results would be jeopardized with 12,866 people on board, what type of enforcement problems will you have if we approve the President's budget that calls for cutting this meager force by another 350? Would you please be specific.

Mr. WALKER. I believe that the submission to OMB that covered that item was the response to what is requested for a generally reduced level, without picking and choosing between priorities. If we were to take the entire Customs Service and lower it a certain amount, what would the effect be and the answer is that under those circumstances there would be a threat to the law enforcement function.

The budget that has been submitted, however, makes adjustments within categories, takes deeper reductions in certain areas than in other areas, and, therefore, we can assure this committee that as submitted to this committee for fiscal year 1986, we do not foresee any jeopardizing

of the existing law enforcement programs or functions. That does not mean that if there were more resources in law enforcement, we would be able to do more. That goes without saying, and that is obvious. In terms of existing programs and in terms of maintaining our existing posture, that will not do that.

Senator DECONCINI. You are telling me you can maintain existing law enforcement but other areas of Customs will be jeopardized.

Mr. WALKER. We submitted a budget that foresees administrative savings through various consolidations, office changes and the like, and at the same time takes advantage of the effort we are making in automation to accomplish these reductions. The administrative savings and the automation programs that we have in place will result, and can result, in savings to the Customs Service. Even if Congress were to reduce all of these items, as has been done in past years, we would still want to achieve these same administrative savings and reductions, because they are the way one should do business in the 20th century.

SenatorDeConcini. I have other questions but I know other Senators have time constraints.

Senator ABDNOR. If I can just pick up, Senator, on your asking about the budget. I am curious, did you appeal this at all, the cuts you got from OMB?

Mr. WALKER. As I recall, there was a process of negotiation that went on and this was handled out of the Office of the Assistant Secretary for Administration in consultation with my office and this was the process of negotiation that resulted in the final figure. It wasn't done on a formal basis.

MAINTAINING CURRENT LEVELS

Senator ABDNOR. Let me ask you this: how many dollars would be needed in fiscal year 1986 to maintain your present level?

Mr. WALKER. The management savings item which results—are you talking about the present level?

Senator ABDNOR. Yes, what would that be?

Mr. WALKER. The proposed cut is 887 positions and that is accompanied by a budget reduction of $29 million. This budget has some increases built into it, as well as decreases. However, the decreases outweigh the increases.

Senator ABDNOR. When you get a chance, will you submit that for the record, if we would leave it at the present level.

Mr. WALKER. Fine.

[The information follows:]

MAINTAINING PRESENT OPERATING LEVEL

In fiscal year 1986, the Customs Service would require an additional $46.6 million to maintain their present operating level. This includes $17.6 million to restore the 5-percent pay reduction proposed for all Federal employees, and the reduction of $29 million and 887 positions proposed in the President's budget.

THE 5-PERCENT PAY REDUCTION

Mr. VON RAAB. Included in our fiscal year 1986 request is a reduction for a 5-percent pay cut of $17,600,000. It is hard to say whether that is necessary to maintaining existing levels because if there is, as proposed, a reduction of 5 percent in Federal pay we would not need that money to retain existing levels. However, there is also a reduction figure of $29 million for management savings; in other words, the changes we are making in order to meet our budget target. Am I clear on that?

Senator ABDNOR. I think so.

What are you going to do if that 5 percent doesn't go through? How would you handle that?

Mr. WALKER. If the reduction doesn't take place? Everybody will take a 5-percent cut if it does go through and if it doesn't, nobody will take a cut.

Senator ABDNOR. What will you do for money? This budget is based on a 5-percent cut.

Mr. VON RAAB. We would have to figure out how we could absorb it. It is equal to a RIF of approximately 1,200 people. If it had to be taken immediately on October 1 with no opportunity to plan for it in other ways, the standard response of any organization would have to be to cut, and we would have to cut some nonpersonnel programs. However, the Customs Service is comprised largely of personnel expenses, so, as a rough guess, that would require a RIF of about 1,200 people on October 1.

Senator ABDNOR. That is something we have to keep aware of.

Mr. WALKER. For the record, that is a budget item of $17.6 million in Customs that would have to be absorbed somewhere.

Senator ABDNOR. Senator Mattingly?

PREPARED STATEMENT

Senator MATTINGLY. I have a statement and some questions you can respond to for the record.

[The statement follows:]

STATEMENT OF SENATOR MACK MATTINGLY

Commissioner von Raab, as you are, I am extremely concerned about the growing illegal drug trade in this country. It is an enemy, both foreign and domestic, which I believe has the potential of destroying our Nation from within by killing and psychologically, emotionally, and physically harming our young people. As we have focused on the problem over the past few years we have seen it grow before our very eyes. You yourself have indicated that the illicit drug trade is a $70 billion a year industry. That is big business. I want to see this business eliminated—completely wiped out. Regrettably, we are a long way from that day. But I do want to take this opportunity to commend the Customs Service for the successes it has seen. The number of seizures and the ever increasing amount of these seizures is encouraging.

USE OF MILITARY PERSONNEL

Senator MATTINGLY. Let me ask you this question: obviously you are getting restrained and we need fiscal restraint; we have a big deficit. But how about other sources within the Federal Government that you could utilize in reference to the drug battle? I know Senator DeConcini has put in a bill which I have cosponsored to establish a new unit, military type unit, but why not use some of the current military personnel more than we do? Are you making any movement in that area?

Mr. WALKER. Yes; I think it is fair to say we are, and, again, I would like to thank Senator DeConcini for his initiative in this area. We have worked closely with the Senator and other Members of Congress on this. We are sensing today, in the Pentagon, a much greater willingness to recognize the need for a Pentagon contribution to this effort and a greater willingness on the part of the Defense Department to contribute resources to this drug fight.

Senator MATTINGLY. Where, who? Is this the Secretary of Defense, and who is appealing to him, the Secretary of Treasury?

Mr. WALKER. The Secretary of Defense has been spoken to by the Secretary of Treasury. They have discussed it and within the immediately lower levels of the Defense Department we are sensing a much more positive response. The special operations unit that has been proposed by Senator DeConcini and Congressman English is under very serious consideration and at this point I think it is fair to say that the probability of Pentagon acceptance is quite high. I obviously cannot guarantee anything from another department, much less my own, but we think this is a realistic goal, and it evidences a greater willingness on the part of the Pentagon to participate in this effort. We are at the same time working with them. They have, in effect, the lead, because they have so many more resources they are being asked to contribute. I sense no opposition to this program in the Treasury Department.

Senator MATTINGLY. What would make it easier for you then to utilize those people or equipment that they have? This could become law tomorrow, Senator DeConcini's and Mr. English's bill. But it seems there must be some administrative way?

Mr. VON RAAB. The posse comitatus restrictions are still there.

Senator MATTINGLY. But they have been circumvented as far as utilization of other forces.

Mr. VON RAAB. When you get into the actual use of military personnel then you are coming up against a much more serious posse comitatus. The history of that posse comitatus was the bad conduct of the troops in the South——

Senator MATTINGLY. Yes; we recall that.

Mr. VON RAAB. But that is a major restriction on the use of the armed services personnel.

Senator MATTINGLY. It seems to me the scope of $70 billion business in the United States would allow some movement by either the Treasury Department or somebody to try to come up with something, with the great minds you have.

I wonder if you could expand on the specific programs to stop the importation of counterfeit goods from countries such as Taiwan and would you comment at the same time on how effective are you in stopping the flow of the goods and do you plan to increase the use of Customs Service in that regard?

IMPORTATION OF COUNTERFEIT GOODS

Mr. VON RAAB. We mounted a very serious effort 1½ years ago to target all sorts of commercial fraud, whether they be misclassification or copyright violations or matters that are dangerous to your health, under the program called Operation Tripwire. We have assigned a large number of Customs import specialists and Customs agents to the textiles and steel programs. We are now tracking over 580 cases in the steel and textile areas, most of which are in the textile area. We have a special commercial fraud command center in headquarters which coordinates all of these efforts. With respect to copyright violations, we have been working very closely with the anticounterfeiting coalition, and they are pleased with our efforts.

To sum up, we have a substantial commitment of resources in the textile and steel areas, and we believe we have made great progress toward preventing and stopping the smuggling of counterfeit items.

Senator MATTINGLY. But it is still going on. Mr. von Raab. It is always going to go on as long as there are short businessmen who occasionally turn the corner and become crooks. We will always be vigilant. I cannot say it will ever be stopped. The market is too great. People are often too willing to buy these products at those prices.

Senator MATTINGLY. Isn't that called stealing?

Mr. VON RAAB. It is a crime.

FIRST NATIONAL BANK OF BOSTON

Senator PROXMIRE. On page 4 of your statement, Secretary Walker, you refer to the First National Bank of Boston's failing to report transactions of $1.22 billion and the fine was $500,000. That seems to me to be absolutely peanuts. You can take $1.22 billion for a month and come up with $12 million interest. It is a pretty profitable operation, $500,000 is nothing. It is a nice cost of business. I realize First National Bank of Boston was hurt badly by the report and it may be that that would be one way of disciplining that kind of operation, but it seems to me we ought to have fines that are commensurate. Was this an administrative decision?

Mr. WALKER. This was a plea agreement between the U.S. attorney and the First National Bank of Boston. It was confined to that. That agreement did permit the U.S. attorney to continue the investigation and in the event that they found that there was criminal culpability on the part of any employee who acted by virtue of any outside influence, then all bets are off and the bank can be fully prosecuted and any employee can be fully prosecuted. The plea was limited to that kind of situation.

I do not think anyone at the time anticipated the wave of publicity that would attend this matter. The U.S. attorney did not. We do not feel at Treasury that the limit of $500,000 in a case of this magnitude is in any way precedent, as far as we are concerned. Other banks have come in and disclosed violations to us. We made it clear to them that there is no program of amnesty for them for doing so. But we encourage their voluntary disclosures and we reserve the right to impose the full range of sanctions.

Senator PROXMIRE. Would not it make sense as a minimum to find out what profits were involved? You know far better than I do, but it seems to me the laundering is often connected with drug dealing. The profits are colossal and the banks share in those profits, to the extent that they can use the money for awhile. It seems to me we need some study to find out how much profitability there is so we can come up with fines that would dissuade them and bring in even more funds than you do.

Mr. WALKER. I would agree with you. In certain testimony Chairman Brown was asked what the profit was and he said that the bank made $1 million.

Senator PROXMIRE. I think he was being very modest.

Mr. WALKER. You might well be right.

STAFFING IN MILWAUKEE

Senator PROXMIRE. Commissioner von Raab, I am extremely disappointed that Customs has decided not to fill the four full-time slots at the Milwaukee office after Mr. De Angelus wrote me and told me you planned to assign the personnel to Milwaukee. I know you wrote me a letter outlining the reasons, but can you tell me why you broke your promise and also why you thwarted the will of the committee as expressed in the report language?

Mr. VON RAAB. We have the highest regard for the direction and guidance of this committee as expressed in the report on appropriation language. In accordance with Senate Report 98-562, we were prepared to increase staffing at various ports as reflected in our letter of December 13. However, in late 1984 and early 1985 various budget concerns and the most effective utilization of available resources required us to make personnel allocation judgments which had an impact on our commitment to Chairman Abdnor. First, work load increases placed a heavy burden on all staffing. Second, Customs was able to absorb one-half of the three increases which were required. Third, there was no pool of inspectors or other positions from which we could draw to comply with the committee's staffing recommendations. Fourth, I had to consider the relationship between current staffing and the 1986 fiscal year budget request and insure that the impact of possible staffing reductions were minimized.

The Customs Service reflects as best we can this commitment in management planning and determining levels. I know we share a common desire to see that Government resources are properly managed and that legitimate savings be made where possible.

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Senator PROXMIRE. In fiscal 1986, next year, things get even worse for Milwaukee. Your budget calls for the closing of the customs office, and the shift of its functions to Chicago. That was the same plan you had a few years back. There are many large exporting and importing businesses in Milwaukee that are relying on an import specialist being on-site. General Electric has a big operation in our State, right near Milwaukee, about 10 miles away, and they would be seriously hurt if you pulled the plug.

Let me ask you, Commissioner von Raab, why are you closing Milwaukee next year and what will it take to keep the office functioning with appropriate staffing and import specialists present in fiscal 1986?

Mr. VON RAAB. This is a comparable question to the Phoenix question that Senator DeConcini asked. We are not closing Milwaukee as a port of entry. Goods will be shipped through Milwaukee and cleared there. There is a proposed change in the characterization of Milwaukee and also the consolidation of the import specialist functions outside of Milwaukee. We don't believe, based upon our experience, and I will ask Mr. De Angelus to go into more detail, if you wish, that the proposed changes we are putting forth will have an adverse effect on the speed or efficiency of the goods moving through the port of Milwaukee.

Senator PROXMIRE. We are not going to have an import specialist there?

Mr. VON RAAB. That is right. Import specialists review the documentation after the goods have been cleared and released into the commerce of the country, unless the goods fall in certain special catagories or are quota goods.

Senator PROXMIRE. My fundamental question is what will it take to keep the Milwaukee office functioning as it has been functioning in the past? What do we have to do—or what can we do? Is there anything we can do?

Mr. VON RAAB. It is difficult for me to answer. Customs management feels that the proposals that it is making are proper. I suppose that you would have to take stronger action than report language and in effect require the Customs Service to do that.

Senator PROXMIRE. Report language may not be respected but if you put it in the statute, of course, you would have to obey the law.

Mr. VON RAAB. Yes.

INSPECTIONAL OVERTIME

Senator PROXMIRE. In fiscal 1984 the customs had over $78 million in overtime, including $63.8 million for inspectional overtime, overtime for inspectors at airports and sea ports and so forth. Have you considered hiring 200 to 300 inspectors rather spend $63 to $78 million a year in overtime? Why wouldn't that make sense and save the taxpayers a bundle of money?

Mr. DE ANGELUS. If I may, we have a number of proposals to deal with the overtime problem. Overtime was established to provide reimbursement for services required outside normal hours of duty. Where it

is justified, we do rearrange hours of duty to have full-time, appropriated staff available. In many instances, there is just not enough work available to have normal full-time staffing on duty, therefore, overtime is scheduled as needed.

Also, many of the services are special, and we believe parties of interest should pay for them. In addition, we are proposing user fees that would not eliminate the payment to our employees but would eliminate charges to outside interests for the overtime.

Senator PROXMIRE. Thank you very much.

Mr. Chairman, I will not take anymore time except to say that this is an unusual agency. It brings in far more money than it costs and it is one where it seems to me we can go a long way toward reducing the deficit by recognizing that it might be a false economy to make cuts. I submit, in some areas you bring in $10 for every $1 you spend. No business would pass up that kind of opportunity, especially when you are enforcing a law and making for a better country. I hope we can work out something that will allow you to do the job you want to do while at the same time reducing the deficit.

Senator ABDNOR. Senator Chiles?

ADMINISTRATIVE CONSOLIDATION

Senator CHILES. Thank you, Mr. Chairman. I appreciate the opportunity to ask a few questions.

Your statement includes the reference to consolidation of personnel into Indianapolis; 280 positions would be pulled away from districts around the country. Approximately 85 positions would come from Miami. We have heard concern about this proposal. What advantage is there in the consolidation? How was Indianapolis chosen and what will happen to the 85 people in Miami who may not want to relocate to Indianapolis?

Mr. VON RAAB. The advantages of the proposal are several. From a pure taxpayer's standpoint, the savings of the salaries of 280 people will be realized. In terms of the management of the Customs Service we will, for the first time, have uniform and more effective personnel, procurement, and logistics practices. There are very real economies of scale to be realized by centralizing these activities in Indianapolis. We also believe this centralization will result in more effective management and standardization of current administrative systems. One of the problems we have had in Customs over the past few years has been a lack of uniformity in certain personnel and procurement practices. If you will, the right-hand did not know what the left-hand was doing with respect to acquiring space or a computer for example. We might have acquired one type of computer for Miami and a different one for Houston. That will not happen if the functions are centralized in Indianapolis. We try to protect against that now but this centralization will make it easier.

As to how Indianapolis was selected, a consulting firm was retained to determine an appropriate location. Out of 107 possible locations they recommended seven sites for our consideration. Based upon the consul-

tant review together with our own information with respect to these areas, we selected Indianapolis. I would be happy to go into more detail about that. I have actually written on one or two occasions letters to Senators or Congressmen describing in more detail the actual process on how Indianapolis was selected and I would be happy to provide a letter addressed to you explaining that as well.

Senator CHILES. I would appreciate that.

The last part of the question was what will happen to the 85 personnel in Miami?

Mr. VON RAAB. The 85 personnel will have a number of options. They will be afforded the opportunity of moving to Indianapolis on a voluntary basis. We will also make vacancies available to some of those 85 people. We do not know how many people right now because we do not know how many will move to Indianapolis but we do plan to give them an opportunity to take other jobs in the same geographic area. I might point out that none of these individuals are in the districts. They are all in the Miami regional structure. So some of them will be offered opportunities for jobs in that area. Others would leave the Customs Service.

CHANGE IN FAA PROCEDURES

Senator CHILES. I appreciate your response to my letter with respect to possible changes in FAA procedures which will improve the interception of aircraft. In a recent hearing, Administrator Engen indicated that he thought those suggestions had considerable merit and should be looked at more closely. In light of this favorable response, could you outline the steps that need to be taken and a mechanism that could be established so Customs and FAA could move to implement these changes?

Mr. VON RAAB. A working group consisting of FAA and Customs staff personnel has been established to work toward the implementation, and in some cases, the promulgation of regulations. I do not have the specific agenda of the working group in front of me. There are a couple of issues that represent a difference in mission between the FAA and the Customs Service. The Customs Service is largely a law enforcement agency concerned with interdicting smuggling. The FAA, as has been expressed to me, is more concerned with the issue of safety. Therefore, if an issue arises that we think is a good idea to prevent smuggling but they think it affects safety, we have a stand off. There will be a few of those issues. I have not been satisfied with the speed of this particular working group, and I have instructed my staff, wherever possible, to use Customs authorities to put these regulations into effect. However, there are certain areas where we will have to rely on FAA's authorities. This is the best I can give you right now on that issue.

Senator CHILES. The FAA is purchasing 44 new radars to be used at the border. I believe there is a real potential to enhance our interception capacity if some technical changes can be made to the original FAA plan for these radars. I understand Customs has a contract with

Mitre to study this and the results are due by May 15. Are the results expected to be received on time and can you give us any preliminary indications?

Mr. VON RAAB. I would like Mr. Corcoran, our Assistant Commissioner for Enforcement, to answer this question.

Mr. CORCORAN. On the first part of your question, we are working with FAA. They have agreed to readjust their schedule of priorities on changing some of the capabilities of the FAA radar, such as installing digitizers that are accessible by our command centers. On the Mitre study, we think we will have the final recommendations by that date. We do have some preliminary results now that will coincide with our efforts with FAA.

Senator CHILES. I have a few questions that I will submit for the record.

Senator ABDNOR. Fine.

Senator Domenici?

NEW MEXICO PORTS OF ENTRY

Senator DOMENICI. Thank you for permitting me to attend, Mr. Chairman. First, let me just say, Commissioner von Raab, that I appreciate the cooperation we have received from you in terms of our growing airport needs in Dona Ana and Las Cruces, NM.

I do have a couple of concerns with reference to ports of entry into the State of New Mexico from Mexico. I understand you have a lot of problems along the entire border, but could I talk with you for a minute about the port of entry at Antelope Wells? Antelope Wells was temporarily closed on March 2, according to what my staff in New Mexico tells me. Why was it closed, and when will it be opened? If it is opened, will it be at full operational capacity?

Mr. VON RAAB. On March 2, nine ports of entry were closed by the Customs Service because of a credible security threat to the lives of the Customs Service officers that we received. As you recall, this was about the same time, or slightly after the execution of the DEA agent in Mexico. We selected those nine ports because of the security risks involved, and the personnel, particularly security personnel, available to staff them, and the distance from assistance of each of the ports. In this case, Antelope Wells is approximately 78 miles to Douglas, AZ, or 90 miles to Columbus.

Since that time the Customs Service has reopened six of those nine ports. Antelope Wells, Los Ebanos Ferry, and Amistad Dam are still without Customs personnel. We have taken existing personnel and existing patrol officers where we could and staffed the other ports. We do not feel we have the resources or staff to maintain a reasonable level of security at Los Ebanos, Antelope Wells, or Amistad Dam.

The Immigration and Naturalization Service has reopened Los Ebanos and Amistad Dam. We disagreed with the Immigration and Naturalization Service on this and did not return Customs personnel to those two locations. INS has put a substantial contingent of their border

patrol there but we did not feel, because of security reasons and Customs' own personnel restrictions, that it was in the interests of the Customs Service to staff those locations.

Antelope Wells remains closed pending further development of the security issue, which has not changed. Just last night we had a shooting, I think it was in El Paso. We have had a number of shootings along the Mexican border over the past few weeks. The security situation remains a concern of ours, compounded by the difficulty of operating a port far from a support center as is Antelope Wells.

Until there is a change in the security situation or our personnel situation, we do not plan to return our staff to Antelope Wells.

Senator DOMENICI. Commissioner, what you are telling me is that there are two reasons for the closure of Antelope Wells. First, let me talk about the security reason, and then about staffing concerns. If I understand you correctly, you could alleviate the dangerous situation for Customs employees if you had additional staff, or more security officers to protect them.

What is the U.S. Government doing in conjunction with the Mexican Government and the States along the border in an effort to alleviate the safety problem? Are we just saying it is dangerous, or is something being done to alleviate it? I understand it is a complex problem.

SECURITY ALONG UNITED STATES-MEXICAN BORDER

Mr. VON RAAB. As you know, there has been a major revisitation of drug trafficking in Mexico as a result of the execution of the agent and as a result of Customs' response to that in its border action. There is a lot of discussion involving Ambassador Gavin and Attorney General Meese. Although I have regular conversations with Ambassador Gavin, I unfortunately cannot give you a good status check on the specifics of the discussions with Mexico. The corruption problem within the enforcement community in Mexico is grim, and therefore, Customs Service does not feel it can rely on Mexican officials to help with our security. A shooting took place 2 or 3 weeks ago in which, even though the shots were fired more or less into the air, when it was over, the Mexican Customs official was seen to have given the fellow a little pat on the back, as sort of a good show.

There is still a serious problem and I hope the actions of Ambassador Gavin and Attorney General Meese will improve the situation. It certainly looks a lot better, at least from the reports I read in the press.

Senator DOMENICI. Assuming that the situation does not change sufficiently for you to believe that Customs personnel would be safe, what would we need to do in the way of protective staffing to allow the three ports of entry that are closed to be reopened? What resources do you need?

Mr. VON RAAB. INS is staffing two ports that are open. However, Customs does not feel they should be staffed.

Senator DOMENICI. But the Customs people are not there. Can those ports of entry perform such services without Customs personnel there?

Mr. VON RAAB. The INS personnel are able to perform Customs functions short of clearing major cargo shipments. Los Ebanos Ferry is a one man rope ferry, and is primarily a tourist attraction. Amistad Dam is very close to Los Rios and is used largely by the border officials who maintain the border area, both United States and Mexican officials, so neither of those have any commercial aspects to them whatsoever. They are really conveniences for personnel.

Senator DOMENICI. What about Antelope Wells? That facility processes about 770,000 cars, and almost 25,000 people into New Mexico alone. General Motors is planning to build a plant in Casa Grandes, Mexico, across the border. Are you telling me that it will be closed permanently?

Mr. VON RAAB. No; having had this conversation, I can assure you we will take a look at it. We believe we will have to put at least six or seven people there, some of whom would be patrol officers and those numbers are hard to find in the Customs Service right now.

Senator DOMENICI. Can we expect you to look into Antelope Wells and give us your opinion as to when, and under what conditions, you can open it? We will do what we can up here to assist you.

Mr. VON RAAB. Yes; we will get back to you and give you a sense of the security and a sense of the kind of personnel necessary to secure it adequately.

PORT AT COLUMBUS

Senator DOMENICI. The port of entry at Columbus, NM, while it is open, I think it is generally considered to be highly inadequate. The building is in a serious state of disrepair. Much of the inspection work has to be done outdoors in all kinds of weather. Are you aware of any plans to improve that facility? Could you look into this particular situation because it causes a lot of concern, too?

Mr. VON RAAB. I am not aware of any plans to change the situation in Columbus, but we will look into it.

MOTOR CARRIER SAFETY ACT

Senator DOMENICI. I have one last question, unless it has been asked. The Motor Carrier Safety Act of 1984, applies to trucking activity coming across the border. I understand that there is a great deal of concern among the various custom-house brokers about the implementation of the Motor Carrier Safety Act. Have you testified about that already?

Mr. VON RAAB. No; I haven't. There is a requirement that Mexican trucks be able to produce certain documentation showing that they have certain insurance coverage. There are some conditions under which they do not have to do that, apparently if they are a truck that is only going to drop something off within a certain band. The Customs Service has not spent an enormous effort in strictly enforcing that law because of the massive defacilitation that would take place. We are trying to determine how we can best enforce the law without causing substantial backups and hardships to those people bringing their trucks across the border.

However, it is fair to say an awful lot of these trucks do not have the proper documents and are not staying within that band.

Senator DOMENICI. I understand that. What has bothered our people along the border is that the word is going out that the act is going to be implemented. Some American companies who are across the border want to comply, but they do not really know what is going to be expected of them. One example is the Xerox Corp. There is a growing consternation that one of these days you will stop all trucks unless they have certain kinds of certification at this time, they simply do not know what to expect.

I am only asking that you realize that this situation is causing growing concern. If you haven't been implementing it fully because of the reasons stated here, I hope you make sure that everybody is given notice before you make a dramatic change, and that everybody is fully informed as to what is expected of them.

Mr. VON RAAB. My personal feeling is that the act should be strictly enforced. We are working with the Federal Highway Administration, and I fully understand the need to provide advance notice. I give you my assurances that I will let you know if we are prepared to take any serious action in that area, and we will also insure that the U.S. truckers shipping from Mexico are also informed.

Senator DOMENICI. Thank you.

Senator ABDNOR. Thank you.

Senator DeConcini?

CUSTOMS-INS PRIMARY INSPECTION PLAN

Senator DECONCINI. Whatever the pleasure of the committee. Thank you, Mr. Chairman.

Mr. Walker, as you recall, Congress scrapped the administration proposed Customs-INS primary inspection plan last year. I felt that it would have seriously damaged drug enforcement at the land borders without significantly improving the flow of legitimate traffic at the border. Back in February you told the Ways and Means Committee that nothing else had been done on the plan since Congress did not authorize it. Yet, a letter from INS Commissioner Al Nelson to you dated March 21, 1985, seems to indicate that at least INS still thinks a plan to consolidate border inspection is alive. Can we safely say that the proposed plan is dead, at least for the fiscal year 1986?

Mr. WALKER. Obviously, bearing in mind the expression of congressional will that resulted in this plan being halted, we have not actively proceeded with this plan. The problems which led to that plan—a duplication of effort, an inefficient use of executive resources overall, the need to develop a rational border inspection program—still persist. In fact, these concerns were raised by the private sector originally and the administration's response was generated by numerous letters and report language that appeared emanating from Congress. So while the plan was not acceptable to Congress, Congress clearly had evidenced to the executive branch, the need for some measures to improve the situation.

Now, in terms of the inner workings of the administration, nothing has changed since the earlier representations to the Ways and Means Committee. But we would like to continue to explore the possibilities of achieving economies and efficiencies in this area.

Senator DECONCINI. Thank you.

MARINE PATROL FLEET

Mr. von Raab, I understand you intend to spend about $4 million next year to operate and maintain your marine patrol fleet of about 134 vessels. Do you have any money in your fiscal year 1986 budget to initiate any new marine modules in the Southeast or Gulf States, and if not, can you tell the committee what level of funding would it take over the next 2 fiscal years to provide the Customs Marine Program with the Blue Thunder boats, radar surveillance boats and other assets necessary to cover the marine program requirements and beef up the marine module concept? Can you be specific at all?

Mr. VON RAAB. To answer your question directly, there is no money specifically identified in the Customs fiscal year 1986 budget for additional marine modules. However, we are planning and have approved two modules, one in Clearwater and one in Brownsville. We plan to finance these modules from our seizures.

Senator DECONCINI. Do you have any plans for additional Blue Thunder cigarette boats?

Mr. VON RAAB. I, like yourself, was very impressed with those boats.

Senator DECONCINI. Just to interrupt you for a moment, I understand there has been some success most recently in that area and that has prompted my question.

Mr. VON RAAB. The Blue Thunder, as you know, is a recent acquisition. I am very impressed with it, and I am going to review our budget to see whether we can acquire some more of those.

Senator DECONCINI. I do not want to make the job too easy for you, but I will do all I can to persuade the chairman to either designate or add a small amount of money to help you come to a conclusion that we should start on a program of adding a few of those.

Mr. VON RAAB. To go back to your other statement, for several weeks we have been working with the State and local officials and Bahamian officials on an operation that has netted tremendous results and we are very proud of this particular program. It has certainly shown us that the threat on the seas is very much there and that air coverage for the marine program is extremely helpful. The only reason I am not going into more detail is because there is probably a more formal mechanism established for dealing with a public announcement of these results.

Senator DECONCINI. We are very proud of those results. Mr. Commissioner, Mr. Walker, a real credit goes not only to your leadership but the agents involved. They put together a good sound program and we would like to encourage that.

NEW AIR FORCE UNIT

As you know, Congressman English and I have introduced legislation that would create, among other things, a 16-plane drug squadron in a new Air Force Reserve unit. Customs would probably fly the aircraft during peace time. A large part of the maintenance would be handled by Air Force while Customs would pay for low level daily maintenance. How would you reconfigure your air interdiction program if the P-3 elements of the air program were shifted to this new Air Force Reserve unit in 1986?

Mr. VON RAAB. That is a tough question, and one that I would normally ask my staff to spend a week on. We would hope the P-3's we now have would be picked up as part of that operation. We would channel whatever additional resources that were available into some intercepting capability, and we would put more resources into aircraft that could support our marine operations. Generally speaking that is what we would do.

Senator DECONCINI. I am glad you are thinking about it and that your staff is getting ready to take a look at that.

Do you anticipate that you can staff the pilots and the crew necessary if this came about, for Customs use?

Mr. VON RAAB. You mean the special wing?

Senator DECONCINI. Yes; if DeConcini-English passed and the special wing was created for 1986, do you think the availability of crew members and staff can be put together?

Mr. VON RAAB. Our fiscal year 1986 budget covers crew and staff for the P-3's, C-12's, and other aircraft, of which you are aware. Those planes in the special wing would require additional pilots.

Senator DECONCINI. If the funding was there, do you think the pilots are available?

Mr. VON RAAB. You mean in the job market?

Senator DECONCINI. Yes, sir.

Mr. VON RAAB. Do you know that?

Mr. CORCORAN. I would think so.

Mr. VON RAAB. I think they are there.

IMPORTATION OF PORNOGRAPHY

Senator DECONCINI. My last question, although I will submit some for the record. I am delighted to see under your leadership Customs is really attempting to crack down on the importation of child pornography. Your statement indicates that seizures were up 122 percent between 1983-84 from 1,918 seizures in 1983 to 4,266 in 1984. I also understand that you have been trying to work with the Postal Service to allow the shifting of suspect mail from New York to North Carolina where the U.S. attorney for the eastern district has been more willing to prosecute pornography cases. What has been your effort to divert mail?

Mr. VON RAAB. We have been thwarted by the Postal Service in this effort. They have come up with some legalism in which they maintain that our action to divert this pornography is slowing up the mails, so we are at a stalemate right now on that effort.

Senator DECONCINI. Do you need assistance from this committee? You can answer that question later, if you would like to give it some thought, because we would like to encourage the post office?

Mr. VON RAAB. We have had some good support from the Justice Department. We certainly appreciate your emotional support in this effort. If we feel you could be of assistance, we will get back to you.

Senator DECONCINI. Do you have any other steps in mind that you could use to crack down on the importation of child pornography?

Mr. VON RAAB. Interestingly enough, pornography is not defined as contraband. From the standpoint of a law enforcement officer, contraband is much easier to deal with because it has a de facto illegal character and there are fewer procedural steps required to forfeit or seize contraband, therefore, you can act more effectively. That is one thought right off the top of my head.

Senator DECONCINI. Thank you, Mr. Chairman.

Mr. VON RAAB. Another possibility might be the use of administrative forfeiture for seizing some of this. Of course, that might go hand in hand with the contraband issue. If it were contraband, we could seize it administratively.

Senator DECONCINI. Do you have the authority to do that now?

Mr. VON RAAB. No; a cumbersome procedure is required now. We have to collect the material, put it on schedules, and prosecute the material itself, just like the seizure of a large boat and it must go through judicial forfeiture.

Mr. WALKER. It is the difference, basically, between types of seizures. If we were to seize some commodity, such as a car or some other vehicle which was not involved in bringing in drugs, but somehow subject to forfeiture, we would have to go through judicial forfeiture. Whereas if you had contraband, itself, you could seize it automatically.

Senator DECONCINI. Without pinning you down, do you think the Treasury Department would support legislation making child pornography contraband?

Mr. WALKER. I cannot conceive of any reason that we would not do so.

Senator DECONCINI. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you.

FORFEITURE FUND

What impact has the new forfeiture law had?

Mr. WALKER. I do not think we have a backlog of experience.

Mr. VON RAAB. Since we are still not appropriated we have no money to spend, therefore, it is hard to say what impact it has had. I think it will have a good impact. Customs officers are enthusiastic as we see greater opportunities to use these funds for the conversion of equipment and for the payment of information, but in actual practice, we have not used the fund yet. Until these funds are appropriated we must delay some planned procurement actions. It would be very helpful if you could put some money into the fund.

Senator ABDNOR. The general supplemental seems to be dragging and will continue to do. We will see if it can make a pitch for an urgent supplemental.

Why is it necessary that both the Department of Treasury and the Department of Justice need separate forfeiture funds?

Mr. WALKER. Well, I think that having different policy objectives between departments, in many cases, means that the operation of the funds themselves is best administered by each agency. Basically, it was anticipated that the Customs forfeiture fund would cover customs seizures and would be available to Customs for the various expenditures that are permitted out of the fund, whereas the Justice Department funds would be available to Justice. It is administratively the way Government works. If there were a single fund it would seem to me to be a breeding ground for potential conflict between the departments as to who would actually be using the fund for what purposes. That can be averted by having the two funds. I do not think having a single fund is desirable.

Senator ABDNOR. Why is the Justice fund so much larger?

Mr. WALKER. Well, unless we have experience with the fund, it is hard to determine whether our fund is adequate or inadequate. Obviously if we feel there is a need for a larger Treasury fund, we will be back up to this committee requesting authorization for that.

Senator ABDNOR. Are you telling me they have more reason for it over there?

As I understand it, they have $20 million and I think we have $8 million. Does that mean they have 2½ times more need?

Mr. WALKER. The Department of Justice fund does not cover a single agency. The Customs forfeiture fund does. The Department of Justice covers DEA and FBI jointly. If you look at the investigative personnel there, you see that there is a possible greater need for a higher level in the case of Justice. But I am not going to comment further on that because I am not in the Justice Department. I would say that we would stand by my earlier statement that if we feel this fund for Customs needs to be expanded, we would come back to the committee to do that.

USER FEES

Senator ABDNOR. One last question. Could you tell me—we talked about the user fees. Let me discuss that for a second. How are you going to implement that user fee?

Mr. VON RAAB. There are two proposals which are compatible.

Senator ABDNOR. Can you just put in a user fee or is it legislated?

Mr. VON RAAB. I am not sure of the congressional process through which these things must pass but there are two proposals. One is a proposal to allow for the reimbursement by local authorities of the actual salaries and expenses of inspectors at ports which fall below a certain set of criteria. That is actually built into our fiscal year 1986 budget request before you, although proposed legislation will have to be for-

warded through the authorization committee and this committee. That is a smaller package we can call the reimbursable ports package. There is a larger package proposed called the user fee package in which the Secretary of the Treasury would be authorized to prescribe and collect fees for processing persons, aircraft, vehicles, vessels, and merchandise arriving in or departing from the United States in an amount sufficient to cover Customs' costs. Mr. De Angelus can go into more detail and he may be able to tell you where it is at this point.

Mr. DE ANGELUS. Senator, we have heard six Senators this morning express concern about Customs resources and over the past 6 or 7 years we have had many private international community interests come in and express concern about Customs resources. Over the past 2 years they have offered to pay for additional services. As a result of that a bill was passed to provide Customs services at five small airports on a reimbursable basis. Our appropriation request for that account is before your committee.

We are proposing to respond to all these interests, airline interests, port interests, importer interests, bridge and tunnel authority interests by establishing, what we consider, very modest user fees to finance the cost of Customs' services for a total of approximately $500 million. We are talking about a $2 charge for an airline passenger.

USER FEE REVENUES

Senator ABDNOR. How much do you anticipate it could bring in?

Mr. DE ANGELUS. One-half billion dollars.

Cargo would clear within 30 hours from time of arrival and arriving air passengers would clear customs in no more than 45 minutes.

Senator ABDNOR. Good luck. We will see what happens when you go to the Finance Committee.

Mr. WALKER. Mr. Chairman, if I could add one thing to this proposal. We feel that this proposal is a very worthwhile proposal and that all too often we find the Customs Service having to respond to parochial requests and they spend taxpayer dollars to serve the interest of a private company or a private group, a private group that is wealthy and can afford to pay relatively modest user fees. Considering the fact that the nonenforcement efforts of customs do serve the interests of the importing and exporting community and are so heavily involved in serving private interests, we would like to see this committee, and you, particularly, Mr. Chairman, if possible, embrace the concept of user fees on this basis. Apart from the fact that we think it makes good sense from the governmental perspective that taxpayer dollars generally should not be used to serve the interests of private groups, it would also end the hours and hours of rangling we have over ports, over how the commercial operations should be directed, what the resource level should be and the like. If they want more resources, they pay for them.

Senator ABDNOR. The only thing—I could embrace that, but one thing I would want to be certain of, the money goes in addition to what we are doing now. They will say now that we have this money coming

in, we can knock off what we are doing. They are talking about user fees in the park, and people that went along with a lessor fee in the past are complaining not all that money is being used. If we have a user fee it will be tied down so we can do the things we want to do.

Mr. WALKER. The committee will still maintain its tight oversight to make sure that the money is spent.

Senator ABDNOR. They can reduce the money out of the Treasury and say your dollars are coming from the user fees.

Mr. WALKER. If you have a $700 million budget for Customs and $400 or $500 million of it can come from user fees, obviously, you would not have to appropriate all $700 million because a substantial portion of it would be taken care of by user fees. That would reduce the burden on the taxpayer without reducing the services to the importing and exporting community and others who have nonenforcement related interests.

Senator ABDNOR. I won't argue that, but we could have the user fee.

ADDITIONAL COMMITTEE QUESTIONS

I have some other questions, but we have been here a long time. I am going to submit the questions for the record. I think we have questions from Senator D'Amato and Senator Weicker for the record.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

QUESTION: What was the original budget request to OMB for FY 1986? What was the passback? Did Treasury appeal? What enhancements were included in the original request?

ANSWER: Treasury's budget submission to OMB requested $674,000,000 for Customs' Salaries and Expenses FY 1986 appropriation. The OMB passback was $636,002,000. We appealed $2 million for the Customs Forfeiture Fund and $1.1 million for recurring costs related to the OCDE FY 1985 Supplemental, and both were approved.

Listed below are the enhancements included in Customs' FY 1986 submission to OMB.

- Marine Anti-Smuggling modules ($6.1 million).
- Acquisition of Fiber Optics Detection devices ($300,000).
- Further development of an Integrated Telecommunications Network ($2.8 million).
- Expansion of the Automated Commercial System ($6.6 million).
- Design and Development of TECS II ($4.0 million).
- Additional Motor Vehicles ($1.5 million).
- Sector Console Replacement ($300,000).
- Radio Voice Privacy Equipment ($5.7 million).
- Placement of Wind Tunnels at many major airports ($500,000).

QUESTION: The Budget calls for a reduction of 873 positions. For the record, could you outline where these cuts will be made? What impact will this have on revenue collection? Narcotics interdiction? Cargo and passenger processing?

ANSWER: Customs FY 1986 budget request provides a reduction of 887 average positions as follows:

Position Category	FTE
Inspectors	-206
Import Specialists	-244
Stenographers, Typists, and Secretaries	-10
Other Clerks	-7
Customs Aids	-45
Laboratory Employees	-50
Other Regional and District Employees	-263
Other Investigative Employees	-19
Headquarters Employees	-30
Part-Time and Temporary Positions	-13
	-887

The proposed reductions will have no adverse impact on Customs effectiveness in revenue collections, narcotics interdiction or cargo and passenger processing. Of the 206 inspector average position

reduction, 111 inspectors are merely converted to a reimbursable basis and the remainder are non-front-line supervisory and management positions.

QUESTION: Why are you proposing to reduce import specialists? Won't this adversely affect cargo processing?

ANSWER: Good management requires that we make more effective use of our resources and that we find ways of doing more with less. One of these ways is a wide spectrum of automation initiatives that are referred to as the Automated Commercial System (ACS). We believe that with the implementation of ACS, we should concentrate import specialists at fewer appraisement locations in order to fully utilize the automation capabilities, increase uniformity, and improve productivity.

For your information, the import specialist function in 18 duty assessment locations was transferred in total or part in 1983. Although considerable opposition to the move was expressed in certain centralized locations, this transfer took place without any major problems or disruptions in service to the community. It did not mean an end to Customs presence in the centralized locations, nor any curtailment of the services we offer there. Neither the release of merchandise nor the initial review of entry documents was affected by the transfer of import specialists.

QUESTION: Could you briefly outline trends in commercial fraud. What is being done to combat it? If automation is expanded, won't it lead to more fraud?

ANSWER: Historically, Customs fraud cases mainly concerned the evasion of duties through the under or overvaluation of the value of imported merchandise. Due to current trade related legislation, however, present fraud cases revolve around the evasion of trade agreements and frequently do not involve revenue questions. As additional trade agreements are instituted, usually effecting steel and textile commodities, it is anticipated that the trend toward non-revenue cases will increase.

The following efforts have been taken to combat commercial fraud:

° Customs has reallocated additional manpower to fraud detection, prevention and investigation. Investigative manpower levels have increased each year.

Years	82	83	84	85
Special Agents	55	85	127	150

° The Customs Fraud Investigation Center was established in Customs Headquarters to monitor fraud enforcement and investigative activity.

- District fraud teams have been formed to concentrate fraud efforts at a local level.
- Training has been redesigned to focus on current fraud trends.
- Task forces have been instituted at various ports to concentrate fraud efforts on specific commodities.
- New technical equipment such as Mobile Metal Analyzers are being used to detect fraudulent imports.
- Increased public awareness projects and industry liaison are being undertaken to develop sources of information relative to fraudulent importations.
- Some results are:

	FY 82	FY 83	FY 84
Arrests	15	8	119
Indictments	21	35	160
Convictions	22	28	117
Recoveries	$18.1M	$30.1M	$29.9M
Seizures	$23 M	$49.1M	$62.6M

Automation:

- The automation being instituted by Customs is designed to focus cargo inspections and merchandise examination on high risk/value cargo. This will free inspectors and import specialists from routine, low risk cargo examinations and aid in the development of quality fraud cases.
- Treasury Enforcement Communications systems has proved to be an invaluable enforcement aid and the new generation of automation aimed at cargo inspections should prove the same.

QUESTION: For the Record, could you give a breakout by region of numbers of employees who will be affected by centralization?

ANSWER: The number of employees affected by centralization are provided below by region.

REGION	# of Employees
Northeast	70
New York	129
North Central	63
Southeast	83
South Central	29
Southwest	84
Pacific	63
	521-Total

This chart represents the total number of on/board permanent administrative employees that are currently in each region as of April 19, 1985.

QUESTION: Also for the record, would you provide your plans for regional and district consolidation?

ANSWER: Customs is proposing to redesignate 14 or 44 districts and 27 of 57 appraisement centers. Under current plans, Customs will operate through 30 full service districts, which will include all enforcement, inspectional, and appraisement functions. Entries will continue to be filed as previously, but the actual processing will be at the appropriate district office. In addition, Customs will review the regional functions and configuration with the objective of establishing the most efficient organizational configuration.

Customs is proposing to consolidate current drawback activities at nine locations into one central processing center. Customs is also considering consolidating all field laboratory analyses. These laboratories will be fully staffed and equippped to efficiently process Customs commercial and enforcement workload.

QUESTION: What is the status of the marine program? Will all of the Modules be operative by the end of the year?

ANSWER : We are improving our detection, sorting, tracking, interception and apprehension capabilities through the use of dedicated sensored aircraft, tethered aerostats, transponders, rooftop radars, and acquisition of high powered offshore interceptors. We are improving our communications through the use of HF/SSB voice privacy system and our air/marine operational response through the establishment of C^3I's. Customs is implementing marine modules in the high threat areas and using strategic and tactical intelligence in concert with investigation techniques and concepts in order to obtain the optimum deployment of resources.

Customs has implemented Marine Modules in Ft. Myers, and Ft. Lauderdale, Florida, and New Orleans, Louisiana. We are procuring the vessels and equipment for FY 85 implementation of Modules in Miami, Key West, Key Largo, West Palm Beach, and Port Canaveral, Florida, New York, and Galveston, Texas.

QUESTION: The Air Program is being enhanced. Could you briefly outline the enhancements?

ANSWER: Current or planned enhancements to the Customs Air Interdiction Program include the following:

- Four new Citation II interceptor aircraft equipped with F-16 radar and IRDS were added to the fleet early in FY 85.

- The Piper Aircraft Corporation has been awarded the contract to produce for Customs eight high endurance tracker aircraft equipped with F-16 radar and IRDS. The first Customs High Endurance Tracker (CHET) aircraft is expected to be delivered in August 1985, and one will be delivered each month thereafter, until eight are received.

- Customs currently operates one P-3A aircraft as an airborne radar detection system. Five additional P-3A aircraft are to be delivered to Customs by the end of CY 1985, bringing to six the number of airborne radar systems that will be operational.

- Customs is scheduled to receive six C-12 aircraft from the U.S. Army in FY 86. These aircraft will be modified with 360° marine surveillance radar and mini-FLIR to greatly enhance Customs Air-Marine Interdiction interface.

- Customs received two additional Black Hawk helicopters from the Army in FY 85, significantly increasing Customs apprehension/response capability. Two additional Black Hawk helicopters are expected to be received by Customs in FY 86.

- Two Regional Operational Control Centers (ROCC) have been staffed to provide Customs with additional land based radar detection capability.

- Customs recently completed the operational testing of a third Aerostat (Caribali) with very positive results. These three Aerostats provide Customs with greatly expanded detection capability.

- The C^3I facility in Miami is being expanded to include detection systems and personnel in support of the marine interdiction effort. This will provide for greater coordination of Air and Marine resources in the overall interdiction effort.

- Several legislative proposals have been developed by FAA and U.S. Customs which, when they become law, will greatly enhance Customs ability to sort air traffic and to identify suspect aircraft.

- Customs FY 86 O&M budget includes $5 million for the development of a 360° radar for use on the P-3A or a similar type of aircraft. A 360° radar capability would greatly increase the effectiveness of the airborne detection platform.

- Customs is enhancing our tactical intelligence capability through placement of dedicated intelligence personnel at each of our Air Operations Branches.

- An Air Unit was established in New York on January 15, 1985, to respond to the Air and Marine smuggling threat in that region.

QUESTION: What is the centralization of appraisement centers? Could you provide for the record the changes in locations?

ANSWER: The centralization of appraisement centers relates to Customs' proposal to redesignate 30 Customs districts into full service districts. Each of these districts will include an appraisement center with responsibility for the full range of commercial processing.

Listed below are the proposed locations of the full service district/appraisement centers.

1. Boston, MA
2. Ogdensburg, NY
   Champlain
3. Buffalo, NY
4. Philadelphia, PA
5. Baltimore, MD
6. New York, NY
7. Newark, NJ
8. JFK, NY
9. Norfolk, VA
10. San Juan, PR
11. Virgin Island, VI
12. Miami, FL
13. New Orleans, LA
14. Laredo, TX
15. El Paso, TX
16. Nogales, TX
17. San Diego, CA
    San Ysidro
18. Los Angeles, CA
19. San Francisco, CA
20. Seattle, WA
21. Honolulu, HI
22. Pembina, ND
23. Detroit, MI
24. Chicago, IL
25. Great Falls, MT
26. Cleveland, OH
27. Dallas, TX
28. Houston, TX
29. Tampa, FL
30. Charleston, SC

QUESTION: Could you briefly discuss the processing procedures used by Customs at airports and how each is working? Are plans for future changes in the works? Will the personnel reductions affect the processing.

ANSWER: Customs uses two basic passenger processing configurations. The first is a one-stop combined agency Processing System (CAPS) in which INS and Customs personnel are cross-designated and perform all primary inspection functions (i.e. screen for Customs, INS and APHIS) similar to a land border arrangement. The second is a two stop configuration in which INS and Customs are stationed at separate locations. INS usually screens arrivals prior to baggage pickup and Customs screens after baggage pickup. At many major airports where this configuration is in use it is augmented by Citizen By-Pass. Aliens report to INS for admissibility and then proceed to Customs for examination and U.S. Citizens report directly to Customs for admission and examination without seeing an INS inspector.

In many two stop arrangements, Customs utilizes a Red/Green self-selection system in conjunction with roving inspectors to identify risk passengers and, as an adjunct, facilitate low risk passengers.

Customs is continually updating and refining passenger processing techniques. At the current time, CAPS prior to baggage pickup is our preferred processing arrangement for new facilities. If a new system is developed which is more facilitative without a reduction in enforcement capability and is at least as efficient as current processing procedures, it would be utilized.

Reductions in personnel in conjunction with expected traffic increases will have a negative impact on our processing efficiency. Processing time will be extended. We hope to be able to offset these factors through developments of intelligence that

will assist in identifying high risk flights and passengers as well refining our current processing techniques.

QUESTION: Steel and textile fraud are big problems. What is Customs doing with regard to steel and textiles?

ANSWER: Major textile initiatives:

° In 1984, Customs increased its commitment to textile enforcement by adding 64 positions to the program. Many of these positions were dedicated for expansion of our textile and apparel enforcement efforts in foreign countries around the world.

° Establishment of a four person Textile Section in the Customs Fraud Investigation Center.

° Initiation of two textile task forces in New York and Los Angeles in FY 84.

The Los Angeles Textile Task Force was terminated on July 1, 1984. The final statistics follow:

Seizures	19	Value	$1,311,463
Penalties	4	Value	$1,595,786
Cases Opened	36		
Cases Active	30	(includes 4 referred for criminal prosecution)	
Cases Closed	6	(disposition pending)	

The New York Textile Task Force was terminated on October 1, 1984. The final statistics follow:

Seizures	116	Value	$12,227,457
Penalties	11	Value	$11,290,100
Recoveries	5	Value	$271,005
Arrests	3		

° Total textile seizure statistics as follows:

FY 84	Seizures: 271 Domestic Value: $31,719,520.80
FY 85 to Date (10/84 - 3/35)	Seizures: 155 Domestic Value: $13,125,744

Major projects underway to combat textile problems:

° Intensifying efforts relative to transshipments via Japan, Panama, the Caribbean, and the Middle East.

° Cooperation with the Committee for the Implementation of Textile Agreements on debiting supplier quotas for past overshipments and misdescriptions.

° Initiation of investigations by four of our foreign offices into the alleged transshipment of Japanese acrylic yarns to evade 24 percent dumping duties.

- Publication and distribution of a Suspect Foreign Shippers List and an exchange of information with the EEC on fraud violators.

- Increasing emphasis on Forward Inbond Program to detect possible transshipments via the United States to the EEC.

- Assistance in preparation and preliminary coordination of two special projects proposed by and dealing with counterfeit goods (Detroit) and transshipments via the Maldives (Newark).

- Increasing reliance upon various economic indicators such as quotas and market trends to identify commodities susceptible to circumvention.

- Intensifying efforts at targeting possible 807 violators through inspections and audits.

Steel:

- As of April 1, 1985, U.S. Customs has 52 Special Agents working on 70 class I steel fraud cases. These cases involve violations of the Trigger Price Mechanism (TPM), violations of the European Economic Community (EEC) licensing agreement, false descriptions of merchandise or country of origin to avoid dumping and countervailing duties, and removal of country of origin markings on steel and steel products to conceal the foreign country of origin.

- The Customs Service anticipates an increase in steel fraud with the implementation of the Voluntary Restraint Agreements (VRA) which are designed to restrict the quantity of steel imported into the United States.

- The Customs Fraud Investigation Center in Headquarters is monitoring various government data bases to detect changes in patterns of shipping and exporting countries, taking an econometric analysis approach to targeting of steel fraud and maintaining close dialogue with other government agencies and domestic trade associations.

- Fraud teams in the major steel ports are conducting intensive screening of steel importations. Mini task forces utilizing an interdisciplinary approach, as well as, a Mobile Metal Analyzer will be in operation this summer.

- Within the past year there have been major task forces using the interdisciplinary approach in Detroit, Newark, New Orleans, Houston, Los Angeles, and Portland, Oregon. The task forces have been assisted by Department of Justice Special Prosecutors, U.S. Attorneys and Federal grand juries.

QUESTION: What is the status of ACCEPT? Under this system, who makes the decision as to which shipments are inspected?

ANSWER: The automated ACCEPT system is currently operational at 34 ports nationwide. A non-automated version, which requires a physical review of print-out listings of the system's' reference files, is also currently operational at 30 ports.

We are currently in the midst of implementing a cargo selectivity module into a larger Customs system, the Automated Commercial System (ACS). This module's cornerstone is ACCEPT, with enhancements. It is estimated that by June 1, the ACS Selectivity module will be in place at all ACCEPT locations.

In both ACCEPT and the ACS/Selectivity module, examination/inspection direction is provided by the system following a comparison of selected data from an instant shipment with automated reference files. An "intensive" examination direction will be given:

a) if the data matches risk criteria developed by Customs personnel, other governmental agencies, etc. These criteria are developed based on prior knowledge and experience with the merchandise, country of origin, or the parties in interest

b) if the importer involved is new to Customs or to the instant port. Since no "track record" exists, an examination is performed automatically. Findings will determine subsequent handling; if discrepancies are found, criteria will be developed, and repeat shipments will receive intense screening

c) on a random sample basis. All shipments are subject to a scientific random selection structure to provide an effectiveness measurement of our data base.

QUESTION: High technology transfer is an ever increasing problem. Could you briefly describe the current status of EXODUS? Has it been successful?

ANSWER: EXODUS today is a much more mature program than it was over 3 years ago when it was initiated (January 1982). EXODUS has succeeded beyond our expectations in achieving a balance between the needs of legitimate U.S. exporters and the enforcement of our export laws.

Today, 86 percent of what Customs examines and detains at our borders is ultimately seized for being in violation of our export laws. U.S. exporter complaints about this more selective and better targeted inspectional program are almost non-existent. On the other hand, and with the help of our allies and friends abroad, Customs has succeeded in destroying whole international technology and munitions diversion networks who were able to move their cargoes around the world almost at will before the start of the program. Customs recent success in the seizure of U.S. manufactured "side looking" sonar in Japan before it could be installed

on a Soviet oceanographic vessel; the German seizure of a photomicrodensitometer as it was being smuggled to East Germany from the West and the recent indictment of a group of arms smugglers for violation of our RICO statute are prominent examples of the success of our investigative strategy. Customs is increasingly capable of preventing the loss of our technology and munitions to proscribed destinations before these can injure the national security.

Finally, in what we believe to represent Congressional recognition of the success of EXODUS, the House on April 16, 1985, passed a version of the Export Administration Act (EAA) which assigns to Customs exclusively the role of EAA enforcement abroad. This Bill (H.R. 1786) will allow both Customs and Commerce to use their complimentary assets in stopping illegal exports.

In FY-84, EXODUS resulted in 258 arrests, 354 indictments and 136 convictions for violations of the EAA and the Arms Export Control Act (AECA). To date, EXODUS is responsible for over 4,000 seizures valued at over $255 million.

QUESTION: How much is spent on overtime by the Customs Service? Of that amount, how much is for inspectional overtime? Isn't that amount excessive?

ANSWER: In FY 1984 a total $78.8 million was paid in overtime. Of the $63.9 million paid for inspectional overtime, $42 million was reimbursable overtime paid by private parties benefiting from special services. The Customs Service stringently monitors all overtime costs and, given the time span Customs employees must be available for cargo and passenger processing, we believe these overtime costs are reasonable. The majority of inspectional overtime is reimbursable from commercial and private aircraft and vessels for service at night and on Sundays and holidays.

QUESTION: Voice privacy is very important to Customs interdiction efforts. What has been done? What will be done in FY 1986? What will be left to do at the end of FY 1986?

ANSWER: Customs has deployed 819 mobile and 724 portable radios, and have on order 368 mobile and 244 portable radios.

In FY 1986 our efforts will be limited to finishing any remaining installations, training, realignment of the network fixed stations to assure adequate radio coverage. No funds are in the FY 1986 budget.

After FY 1986 funding will be requested to order and deploy 1,400 mobiles, 1,400 portables, 280 fixed stations, 150 code inserters, 300 remote consoles and other supporting radio voice privacy items to complete the nationwide conversion program.

QUESTION: Money is being requested to upgrade Treasury Enforcement Communication System (TECS). The Immigration and Naturalization Service uses TECS. Has any effort to integrate your system with theirs been made?

ANSWER: Yes. Currently, the Immigration and Naturalization Service (INS) provides a monthly computer tape of approximately 40,000 suspected aliens to Customs for inclusion in TECS. These records are accessible from TECS primary inspection terminals located at Customs and INS inspection stations at land borders and ports. The monthly tape is generated from the National Automated Immigration Lookout System (NAILS) which is maintained by the INS.

The upgraded version of TECS ("TECS II") will continue to support an interface with the INS. The INS has a representative on the TECS Federal Users Group which is working with Customs to ensure that the requirements of all user agencies are incorporated into the TECS upgrade. Under TECS II, the interface to NAILS will be upgraded to a direct automated link to eliminate the current 30 days lag between TECS and the INS suspect alien data.

QUESTIONS SUBMITTED BY SENATOR MACK MATTINGLY

QUESTION: I have a question in relation to these seizures. Does the fact that larger amounts of illegal drugs are being seized indicate that larger amounts of also actually entering the United States? What percentage of the contraband do you estimate you are successfully confiscating?

ANSWER: Seizure statistics are only one part of what we look at to determine the threat of drug smuggling into the United States. In the case of cocaine, there is evidence that Narcotics Intelligence Estimates (NIE), on which Customs Threat Estimates are based, are low. 1984 estimates, currently under review by the National Narcotics Intelligence Consumer Committee (NNICC), are being revised upward.

Customs seizures of heroin, hashish, and marijuana show a seizure rate of 7-10 percent compared with the Customs Threat Estimate. Cocaine seizures show 26 percent of threat for 1984. This, combined with decreased street prices and increased user levels, suggest that cocaine estimates are indeed too low.

SEIZURE STATISTICS

	1985 NATIONAL THREAT ESTIMATES	1984 NATIONAL THREAT ESTIMATES
HEROIN	10,000 Pounds	9,100 Pounds
COCAINE	130,000 Pounds	125,000 Pounds
MARIJUANA	30,600,000 Pounds	30,600,000 Pounds
HASHISH	300,000 Pounds	300,000 Pounds

1985 MARIJUANA SEIZURES
(1st 3-months of CY 1985)

NATIONAL:

576,755 pounds = 2% of the national threat

SOUTHEAST REGION:

453,543 pounds = 2.3% of the regional threat (19,798,200 lbs) 78.7% of the national marijuana total seized.

FLORIDA:

196,227 = 1% of regional threat and .64% of national threat (34% of the national marijuana seized and 43% of regional marijuana seized)

1985 COCAINE SEIZURES
(1st 3-months of CY 1985)

NATIONAL:

10,541 pounds = 8.1% of the national threat seized

SOUTHEAST REGION:

10,008 pounds = 9.87% of regional threat (101,400 lbs) and 7.70% of national cocaine total seized. This figure is 94.9% of the national cocaine total seized.

FLORIDA SEIZURES:

9,321 pounds = 9.2% of the regional threat and 7.2% of the national threat. This figure is 88.4% of the national cocaine total seized and 93% of the total regional cocaine seized.

1985 HASHISH SEIZURES
(1st 3-months of CY 1985)

NATIONAL:

2,579 pounds = .85% of the national threat

SOUTHEAST REGION:

33.74 pounds = .09% of regional threat (36,000 lbs) and .01% of the national threat. This figure is 1.31% of the National total hashish seizures.

FLORIDA:

28 pounds = .08% of regional threat and .01% of the national threat. This figure is 1.08% of the national total hashish seized and 82.6% of the regional total hashish seized.

1985 HEROIN SEIZURES
(1st 3-months of CY 1985)

NATIONAL:

120.3 pounds = 1.20% of the national threat

SOUTHEAST REGION:

15.43 pounds = 15.4% of the regional threat (100 lbs) and .15% of the national threat. This figure is 12.82% of the national total heroin seized.

FLORIDA:

All heroin seized in the Southeast Region was seized in Florida.

U.S. Customs Threat Estimates represents a middle round figure of those provided by DEA and other agencies in the National Narcotics Intelligence Consumers Committee's National Intelligence Estimates and updated by current information. Actual amounts of narcotics entering the United States are unknown, but may vary from the estimates by as much as 30 percent.

1984 SEIZURES

1984 MARIJUANA:

NATIONAL:

2,926,192.2 pounds = 10% of the national threat

SOUTHEAST REGION:

2,303,297.4 pounds = 10.9% of the regional threat (21,144,600) and 7.5% of the national threat. This figure is 78.7% of all national marijuana seized.

FLORIDA:

1,925,875.5 pounds = 9.1% of the regional threat and 6.3% of the national threat seized. This figure is 65.8% of the national total marijuana seized and 83.6% of the regional total marijuana seized.

1984 COCAINE SEIZURES

NATIONAL:

33,080.5 pounds = 26% of the national threat

SOUTHEAST REGION:

24,901.5 pounds = 30.6% of the regional threat (81,250 LBS) and 19% of the national threat. This figure is 75% of all national cocaine seizures.

FLORIDA:

23,990.3 pounds = 29.53% of the regional threat (81,250 lbs) and 19.19% of the national threat. This figure is 72.5% of all national cocaine seizures and 96.34% of all regional cocaine seizures.

1984 HASHISH SEIZURES

NATIONAL:

21,312.2 pounds = 7.1% of the national threat

SOUTHEAST REGION:

589.6 pounds = 1.9% of the regional threat (30,000 lbs) and .02% of the national threat. This figure represents 2.8% of the national total hashish seized.

FLORIDA:

528.8 pounds = 1.76% of the regional threat and .18% of the national threat. This figure represents 2.5% of the national total hashish seized and 89.7% of the regional total hashish seized.

1984 HEROIN SEIZURES

NATIONAL:

718.4 pounds = 7.9% of the national threat.

SOUTHEAST REGION:

9.9 pounds = 10.8% of the regional threat (91 lbs) and .01% of the national threat. This figure represents .01% of the national total heroin seized.

FLORIDA:

7.9 pounds = 8.7% of the regional threat and .09% of the national threat. This figure represents 1.1% of the national total heroin seized and 79.8% of the regional total heroin seized.

QUESTION: What single tool do you believe would be most effective in enabling you to increase this percentage?

ANSWER: It is most difficult to segregate one specific tool or method that will enable the Customs Service to increase our percentage of contraband drug seizures. The natural instinct would be to emphasize the need for more personnel examining more shipments in more locations and, of course, supported by more real-time intelligence from our overseas counterparts. The Customs Service can take very effective enforcement/seizure action when supplied with intelligence from overseas DEA and U.S. Customs representatives, as well as representatives from the foreign enforcement community through Customs to Customs dialogue.

The current emphasis of the U.S. Customs Service goes well beyond seizure action at the border. Our emphasis is targeting major organizations that purchase ship, smuggle and finance narcotic or dangerous drug shipments to the United States. As such, the single most important tool available to the Service is the ability to thoroughly investigate a smuggling enterprise and disrupt that organization utilizing any and all laws at our disposal. Blanket and concurrent Title 21 authority to investigate major trafficking organizations would better enable the Customs Service to neutralize these organizations by thoroughly investigating the source of financing for the controlled substance and neutralizing the organization by seizing any and all assets which are connected with that organization. Historically, the Customs Service has targeted the financial support of smuggling organizations and seized those finances. The Service has successfully bankrupted smuggling organizations and neutralized their ability to continue a smuggling venture.

QUESTION: The Vice President's South Florida Task Force has been successful in the sense that it has been a deterrent to drug smugglers who have entered the United States through South Florida. This has had a direct effect on the state of Georgia as traffickers have moved north seeking entry to the country. Have your seizure patterns changed in Georgia during the past few years that the task force has been in operation?

ANSWER: Seizure patterns in Georgia have not changed as a result of the South Florida Task Force, nor have there been indications of traffickers entering Georgia because of the Task Force efforts in South Florida.

An analysis of cocaine seizure statistics show that Florida accounted for 96% of the 24,901 pounds of cocaine seized in the Southeast Region during 1984. Whereas, Georgia accounted for 3%. The 3%, 720 pounds, was actually 815 pounds less than 1983 seizures. There have been no cocaine seizures in Georgia through April 23, 1985. Whereas Florida has made 106 seizures totaling 14,472 pounds during the same period of 1985.

An analysis of marijuana seizures show that Florida accounted for 83% of the 2,303,297 pounds seized in the Southeast Region during 1984 while Georgia accounted for .2% of that total. For the period January to April 23, 1985, Florida has seized 245,814 pounds or 47% of the total Southeast Region seizures as compared to 3,565 pounds or .6% seized in Georgia.

An analysis of 1982 through 1985 seizures indicate an increase in cocaine entering the United States through Florida and the Southeast Region. Marijuana seizures for the same period show a slight decline from 1982 statistics and appear to be occuring at the 1984 rate.

Since the establishment of the South Florida Task Force, there does not appear to be any shift of trafficking into Georgia.

QUESTION: Can you briefly describe how your staffing in Georgia has changed over these years and describe the types of operations you use in your anti-drug efforts?

ANSWER : Our staffing in the state of Georgia has increased over the past five years. We have 23 law enforcement officers and six vessels stationed in Georgia.

Our main focus has been towards smugglers in the marine and aviation communities. We have two marine enforcement offices in Georgia. One is in Savannah and the other is in Brunswick. A portion of the personnel assigned to these stations also work inland counties to curb the threat of smuggling by aircraft. We also have an office in Atlanta which is solely dedicated to aircraft smuggling cases.

Currently one of 13 U.S. Customs Organized Crime Drug Enforcement Task Force (OCDETF) core city coordinators is located in Atlanta, Georgia. The OCDETF staff in Georgia has more than doubled under the coordinator, who has both air and marine tactical enforcement units at his disposal.

We currently have seven (7) new positions proposed for the Atlanta office which, in essence, will transfer seven (7) tactical enforcement personnel to the Office of Investigations. This will allow us to increase the OCDETF investigative effort and expand several special operations that are currently on-going throughout the state of Georgia.

Much of our success can be attributed to the interaction between our personnel and the Georgia Bureau of Investigations as well as the local authorities throughout the state. The working relations with these entities has increased measureably in recent years and we are constantly striving for improvement to further our common goals.

QUESTION: What impact will the FY 86 Budget have on your Law Enforcement Activities?

ANSWER : In recognition of the Congressional and Administrative objective for controlling and reducing the deficit, Customs management constrained its FY 86 Budget request to include only the most critical initiatives and those directly related to producing significant future cost reductions and increased productivity. To insure that these budget constraints did not have a detrimental impact on Customs enforcement efforts, programs were carefully reviewed for resource and operational requirements.

Our review indicated that Customs Marine Program resource acquisitions during the past 2 years will increase program effectiveness. It was apparent that considerable progress was achieved in acquiring additional modules as well as other equipment especially communications. Using appropriated funds and internal resources, Customs has implemented 10 modules, all of which will be operational by the end of FY 85 although these units do not fully meet program requirements for effectively protecting our borders, Customs does believe that it now can provide improved enforcement at the most critical vessel smuggling locations.

Furthermore, in FY 86, Customs will augment this capability by using seizures and exchange/sale provisions to implement additional modules. The new Customs Forfeiture Fund will provide the required funding to equip vessels acquired by these methods.

QUESTION: When do you anticipate that the more stringent requirements will go into effect? And what real effect will these regulatory changes have on the enforcement ability of your Inspection and Control program.

ANSWER: On April 1, 1985, five proposed amendments to 19CFR6.14 were published in the Federal Register designed to increase Customs ability to obtain advance information on legitimate private aircraft movements.

These changes are as follows.

1. A requirement that requests for overflight exemptions include detailed justification in terms of cost, time, safety, convenience, etc.

   This will provide Customs District Directors with more comprehensive information on the actual and planned activities of applicants which will, in turn, permit more informed decisions in granting exemptions. It will also expand the number of legitimate flyers which will be able to obtain overflight exemptions. Finally, this information

will better permit Customs officers to identify nominally legitimate overflights which may in fact be illegal.

2. Overflight exemptions will only be granted for aircraft with functioning transponders and actual overflights must be made in accord with Instrument Flight Rules (IFR) including use of the transponder during the flight.

   This will simplify both the tracking and verification of each overflight and provide Customs more complete and more timely information on pending arrivals.

3. Penetration notice requirements for aircraft arriving from outside the United States would be expanded to include flights from Puerto Rico and precleared flights from the U.S. Virgin Islands.

   This will provide Customs with information on flights coming through extremely high risk narcotics trafficker used airspace which is currently unavailable. This will permit Customs to identify specific flights prior to their arrival and decide what, if any, enforcement screening should be conducted.

4. Aircraft which depart the U.S. and fly outside Customs territory but do not land while outside will be required to provide notice of penetration.

   This will permit Customs to identify and track such flights. Currently flights of this type are often mistaken as high risk flights since they appear on radar as foreign arrivals but ones with no report of pending arrival.

5. Penetration notice requirements will be extended from fifteen minutes to one hour.

   This increase will provide Customs more time to conduct the various enforcement system checks necessary to more accurately determine risk, to coordinate any subsequent enforcement actions deemed necessary, and to permit Customs officers to reach the designated landing site prior to the aircraft's arrival.

The comment period for these changes is 60 days. After analysis of comments received and any necessary modifications the final requirements should become effective by October of this year.

QUESTION: When do you expect the legislative changes will go into effect?

ANSWER: The legislative changes relating to private vessels has been submitted to the Treasury Department level. This legislative package is called the "1985 Customs Enforcement Act". We cannot project the expected date or time frame when this law will become effective. However, we expect to have the legislation introduced this session.

QUESTION: What real effect will these changes have on the enforcement ability of the Inspection and Control program?

ANSWER: The legislation will abolish the provision that allows a boater 24 hours to report. After the legislation is enacted, all arrivals must immediately report to Customs. As a result, smugglers will not be able to legally enter, comingle with domestic traffic, and remain in U.S. waters unsupervised, for up to 24 hours. Consequently vessels who do not report immediately, automatically become suspect vessels and will be targeted for an intensified search.

The proposed legislation will also promote our efforts relating to the enforcement of the reporting requirements through institution of stiff penalties for violations. For example, $1,000 for the first violation, $5,000 for the second, and $10,000 for the third. In addition, vessels shall be subject to seizure and forfeiture.

QUESTION: As a follow up, do you need additional legislative authority to augment your efforts? If so, what are your needs?

ANSWER: In response to a follow up for additional legislative authority Customs has proposed a bill containing the following and we ask that these additional items pertaining to private aircraft and small boats be acted upon.

1. Require all aircraft entering the U.S. from foreign to utilize a functional transponder.

2. Require additional information on aircraft arriving from foreign. This information should include but not be limited to passengers names and dates of birth, and this flight plan information must be required to be received at the Customs designated airport at least 1-hour prior to arrival.

3. Require the only means by which a pilot arriving from foreign to cancel a flight plan to be via a direct phone line located at the designated airport. This should be incorporated into the reporting requirements, and accomplished after the flight has cleared through Customs.

4. Establish entry corridors into the 28 designated airports throughtout the United States and require private aircraft arriving from foreign to enter the country via these corridors.

5. Require all aircraft entering from foreign to be at an altitude at or above 5,000 feet at least 50 miles from the border or

under positive control of an FAA facility at least 50 miles from the border.

6. Require small vessels to report immediately upon arrival from foreign rather than within 24-hours after arrival, with increased penalties for violations.

7. Amend Section 584, T.A. to increase penalties for manifest violations and drugs on board conveyances.

8. Amend Section 586, T.A. to increase penalties for illegal transfers and transshipments of merchandise.

9. Add a new Section 590, T.A. to close some of the loopholes in aviation smuggling laws: to prohibit "drops" to vessels; to provide for forfeitu[illegible]or smuggling acts whether or not drugs are found aboard: to provide criminal penalties for violations.

10. Amend 19 U.S.C. 1432a to extend the reporting requirements to vessels involved in transshipment on the high seas or in Customs waters.

11. Amend 46 U.S.C. 12109 to make it clear that pleasure yachts are only exempt from formal entry and clearance but must comply with the other Customs laws.

12. Amend Section 501, Federal Aviation Act (FAA) to require reports when aircraft are sold.

13. Amend Section 902, FAA to make it unlawful to operate aircraft without lights; to make 902 applicable to non-commercial flights; to prohibit illegal fuel tanks; to provide for forfeiture of aircraft; to operate aircraft without proper certification.

14. Amend Section 904, FAA to increase civil penalties for aircraft violations related to reporting to Customs of manifesting.

15. Amend RS 3071 (19 U.S.C. 507) to allow Customs officers to demand the assistance of any person regardless of distance (present law limits such demands to 3 miles and raises the penalty for refusal to assist to $1,000 for $5 to $200. Provides "good samaritan" defense to any person, not employed by the Federal Government, assisting Customs.

16. Amend 31 U.S.C. 5323 to permit informer awards to be deducted from fines, penalties and forfeitures.

QUESTION: You have indicated that in FY 1984, Customs, as part of the Presidential Organized Crime Drug Enforcement Task Force, participated in cases which resulted in 727 indictments and 277 convictions. There were

450 more indictments than there were convictions. What is the reason for this discrepancy? Have these not yet come to trial or were you unable to obtain convictions?

ANSWER: The discrepancy between the reported 727 indictments and the 277 convictions is explained as follows:

a. Most of the defendants have not as yet been tried;

b. Some of the defendants may have amended (superceding) indictments that have been erroneously counted as more than one indictment;

c. Of all OCDETF cases adjudicated as of December 31, 1984, only 10 percent of the indicted defendants were acquitted for all charges or had all charges dismissed. Ninety percent of all indicted/charged defendants have pled or been found guilty.

QUESTION: I am interested in who is being convicted. Are you reaching the heads of these narcotics organizations, the kingpins, or are most of the convicted runners and other individuals who are easily replaced by the organizations? How, in your opinion, can we best get to the kingpins -- and to their financial resources? Are the procedures and authority which Customs possesses adequate to accomplish this? If not, how can we in Congress assist you?

ANSWER: Listed below is a breakdown of convicted defendants brought to trial following OCDETF investigations:

a.	Top Leader	- 15.2 percent
b.	Major Supplier/Distributor	- 21.8 percent
c.	Mid-Level Leader	- 18.2 percent
d.	Drug-Middleman	- 5 percent
e.	Other	- 39.8 percent

These figures demonstrate that not only is the narcotics kingpin being convicted, but that everyone in his organization, from the street dealer to the middleman, is also being arrested, tried and convicted. Whole organizations are being dismantled.

Continued successful prosecution of narcotics kingpins has been enhanced by the Comprehensive Crime Control Act of 1984. Title III wire intercept authority provided under Title 31, United States Code has assured that narcotics-generated dollars and property will be even more vulnerable to that statute's seizure provision.

Congress can help the U.S. Customs Service remove high-level drug traffickers from operation by giving Customs statutory authority, independent of the Drug Enforcement Administration, to investigate narcotics violations originating outside of the United States.

QUESTIONS SUBMITTED BY SENATOR DENNIS DECONCINI

QUESTION: Now, perhaps the reason your productivity has gone up is because your attorneys have dropped by 22.8 percent over ten years, but could you tell the Committee what measures Customs has taken over a decade to reach this startling productivity level ($1 million per employee in revenue collected).

ANSWER: Indeed Customs productivity has increased significantly over the last decade. There are many reasons why these gains have occurred. In some cases, statutory changes such as the new Customs valuation code implemented through the Trade Agreements Act of 1979, have simplified the appraisement of imported merchandise. Procedural changes in Customs formalities through the regulatory process have greatly reduced resource expenditures by reducing the volume of documents to be processed. The introduction of selectivity concepts to cargo processing, both in examinations and entry summary reviews has resulted in substantial savings in inspector and import specialist manhours. These savings have allowed us to maintain pace with increased workloads with fewer personnel. As an example, examinations were conducted at random in the past, except those that were required for duty processing purposes. Now, following specific examination criteria that target examination of high risk importations, the results of cargo examination have become much more productive. The savings are directed to enforcement. Likewise, in 1976, approximately 90 percent of the entry documents were reviewed by import specialists. In 1984, 40 percent of the entries received that level of review. Again, the savings have been directed to more aggressive enforcement of trade programs and to combatting commercial fraud.

The decrease in the number of Customs attorneys during the last decade is due, in large measure, to the simplification of certain Customs laws and regulations. Also, the transfer of certain ruling functions from the legal staff to the National Import Specialist staff in New York has greatly reduced the workload of our Office of Regulation and Rulings.

We are confident that even greater levels of employee productivity will be achieved when our Automated Commercial System is fully operational.

QUESTION: It seems as though much of our time this year has been spent discussing the staffing shortfalls and long lines at the border checkpoints along the southwest border. Now, no one has been encouraging you to crack down on drug traffickers as much as I have -- both in the airports and at the land borders. But I have to say that erratic staffing levels and hours of operation at the border checkpoints has, at times, virtually crippled business along the southwest border. INS was supposed to have a big staffing build up at the ports of entry next year, but the President cut INS staffing instead. He also cut yours. If we were to restore the 887 positions cut by the Administration, what specific staffing improvements would you recommend for southwest border ports?

ANSWER: Customs would retain the 206 inspector positions included in the FY 1986 budget request as a savings. In addition, a portion of the 280 positions identified as savings from the annualization of the FY 1985 administrative services centralization effort would be restored as inspector positions. We would recommend that an appropriate number of these positions be assigned to the southwest border as needed.

QUESTION: **In your opinion, what would be the effect on your drug detection capability along the southwest border if you were to have four aerostats from California through Arizona, and into Texas? How does NNBIS feel about aerostats along the southwest border? I understand they are very favorable.**

ANSWER: By strategically placing four additional aerostats along the southwest border we would substantially increase our detection capability in areas that presently have poor or no radar coverage, however, as you are aware aerostats cannot be covertly placed or operated. To effectively utilize the aerostat in areas where corridors of intrusion are not established requires backup airborne or ground based detection resources to capture those targets intentionally avoiding the aerostat.

In addition to placing aerostats in the southwest we would like to see two other aerostats, one located in the Southern Bahama chain and the other located on the West Coast of Florida. This would complete a radar network that should thwart the majority of aviation smuggling activities into Southeast Florida.

We believe that NNBIS is supportive of the placement of aerostats along the southwest border.

QUESTION: If S.531 is passed, and you do not have to spend the $5 million on R&D for a new radar system, what would you spend the money on? Be specific.

ANSWER: We believe that an excellent use of these funds will be the evaluation of an integrated marine surveillance system consisting of a 360° surveillance radar and a mini FLIR for the C-12 and the King Air tracker programs. The purpose would be to fund a prime contractor to install an integrated surveillance system on a King Air aircraft and demonstrate performance. The proposed radar would be selected from a number of potential radars such as the AN/APS-128PC or LH-504 Mod V which have both marine and air detection capabilities and would be integrated with a mini FLIR system of which there are several potential candidates (Hughes, Honeywell, Texas Instrument). We would propose an option to install the integrated system, if successful, on the C-12s and balance of the King Air trackers presently in Customs inventory.

QUESTION: What happens to drug enforcement at three funding levels Commissioner, your budget request calls for $639 million and about 12,500 people -- a cut of about 880 slots next year. I understand that this level of funding would essentially leave Customs just barely breathing, but still able to function at reduced levels of activity. Tell us in as much detail as you can, what improvements at Customs -- primarily in the enforcement area -- this Committee would see under the following three enhanced staffing scenarios and tell us what level of funding it would take to pay for these various new levels:

Committee would see under the following three enhanced staffing scenarios and tell us what level of funding it would take to pay for these various new levels:

I. Restore all 887 positions cut in the President's Budget

II. Restore all 887 positions cut in the President's Budget -- and add 400 additional positions, bringing total positions to 13,818.

III. Restore all 887 positions cut in the President's Budget -- and add 726 additional positions, bringing total positions to 14,144.

Give us as much detail as you can now and provide more detail for the record.

ANSWER: The reductions identified in the FY 1986 budget request result from the implementation of a series of management and operational efficiencies directed to consolidating and eliminating duplicative organizations, centralizing widespread functions, and converting to reimbursement underutilized operating locations, such as small, low volume service ports. These management actions will not impact Customs law enforcement, facilitation, or processing efficiency. In fact, we believe that more efficient use will be made of available staffing once low productivity locations and or organizations are consolidated.

These programs, when fully developed and implemented, will improve productivity, streamline program operations, enhance organizational and functional efficiency, and abolish duplicative activities. Many of the efficiencies result from Customs efforts to convert labor intensive functions to more automated processing. In total, these actions will free up substantial staffing in future years for enforcement functions. Our objective is to adhere to the precept of better management of government resources and more effective enforcement.

Customs is not requesting the restoration of the 887 reduction included in the FY 1986 budget request and we do not believe that these positions are required; however, assuming the scenarios posed by this question, Customs would allocate additional staffing to various high priority programs.

Restoring the 887 positions requires a funding level of $679,688 million, or an additional $29.0 million (excluding $17.6 million for the five percent reduction) over the FY 1986 Salaries and Expenses appropriation request. With regard to staffing, all positions, except the annualized 280 positions from administrative centralization, are assumed to be restored to their previous functions. Consistent with Customs' long-term objective to convert administrative support positions to strengthen the enforcement program, these annualized savings would be re-directed to the air, marine, and inspectional programs.

An additional 400 positions would increase the budget by $2.4 million for a total $682,088 million. A part of these positions would continue to be allocated to the air and marine programs to support increased P-3A and other aircraft operations and to the marine modules. Other programs receiving positions would be commercial fraud, and inspectional processing at the Southwest border and the sea and air ports along the west coast.

The final additional 326 positions would increase the budget level by $1.6 million for a total of $683,688 million. Customs' primary emphasis for these positions would be improved cargo and passenger processing, regulating audit, and the Canine Program for detecting narcotics.

QUESTION: Can you give me you unqualified assurance that your so-called "1811" reorganization of the Patrol function will not result in any cutbacks in the air, marine, or other enforcement programs, and that pay grades will not be cut back under the new arrangement?

ANSWER: The consolidation of our Tactical Enforcement and Investigative components into one cohesive law enforcement organization within Customs has, as one of its principal objectives, the enhancement of our interdictory effort. The post consolidation organization will continue to insure that assets devoted to pre-interdiction investigations are clearly identified. The new structure will provide us with the flexibility of augmenting those assets when circumstances warrant. At the same time, the structure allow us to utilized those assets on other Customs priorities when workload allows.

The conversion of the current Tactical Enforcement workforce from the GS-1884 to the GS-1811 Series will be done in accordance with Federal Personnel Manual procedures. In the majority of instances, i.e., for those employees at grades GS-11 and below, conversion will be at the same grade level. For some employees at the grade GS-12 and above, conversion from GS-1884 to GS-1811 may involve a reduction in grade. The reduction must be voluntary and we will insure that the employee's salary will be fully covered up to the limits provided by the Federal Personnel Manual. As part of the consolidation, current Patrol Officers at the GS-9 level have the opportunity to compete for promotion to a limited number of Special Agent positions that provide advancement opportunities up to grade GS-12. These positions will support the Interdiction function and will provide current Patrol Officers with promotional opportunities that did not previously exist.

QUESTIONS SUBMITTED BY SENATOR WILLIAM PROXMIRE

QUESTION: Why do you need to increase from $10,000 to 15,000 the money requested for official reception and entertainment expenses? Given the size of the deficit, can't you get along for another year with $10,000?

ANSWER: The increase from $10,000 to 15,000 is to reduce the financial burden on Customs employees who must now, in some cases, use their own money to pay for Customs representation activities. Customs employees are now assuming about $10,000 of these costs and the proposed allocation will reduce this amount by about one-half.

Customs international trade and enforcement activities have been increasing dramatically and we have had a corresponding increase in representational costs. It is difficult to avoid reception and entertainment expenses for high-level foreign officials with whom we are seeking cooperation on international programs and failure to increase the amount will continue the financial burden being placed on Customs officials.

QUESTION: Customs has a role in stopping the illegal export of critical technology. But the Commerce Department and the Defense Department have been squabbling over the ground rules for stopping these exports. How has this affected your efforts?

ANSWER: Most of the discussion between the Defense and Commerce Departments has centered on the variety and volume of U.S. exports which should be controlled for national security reasons. Customs has had no part in these discussions except to favor a listing of the acquisition priorities of the Soviet bloc so that we can target our enforcement efforts against them. Customs export enforcement effort (Operation EXODUS) has complimented the work of both the Defense and Commerce Departments in the general area of export controls.

QUESTION: The Administration is proposing a system of Customs processing fees, which it estimates will raise nearly $500 million in 1986. Do you anticipate any administrative problems in collecting these fees? How much will it cost to administer these fees?

ANSWER: Except for vehicle fees, there will be practically zero cost to the Government to collect these fees. Customs has in place a collection system which collects over $12 billion per year; most fees would merely piggyback on the existing mechanisms.

QUESTION: Give us three specific enforcement initiatives you will take next year to attack the commercial fraud problem in each of these commodity groups?

ANSWER: With reference to the commodities estimated to be imported in violation of existing agreements, regulations and laws, Customs is anticipating a more efficient organization for its regions, districts, and ports. By utilizing automated and selective approaches, and implementing a more efficient

organizational alignment, a positive impact on enforcement activities will result.

The following three planned initiatives will enhance the efficiency of enforcement activities:

A. Overall, seasoned/experienced personnel assigned to the Fraud Operations Branch, Office of Investigations, will, in May 1985, begin conducting intensified and advanced training on fraud investigations to special agents, district fraud team members, and other concerned Customs personnel within the seven regions.

B. Specifically relative to steel imports, the Pacific Northwest has been targeted as the initial area for initiation of Steel Mini Task Forces. The first will begin in the Seattle district, which includes the ports of Seattle, Tacoma, and Blaine. A second is planned for the Portland, Oregon, district, and a third mini task force is anticipated for the San Francisco district.

C. In relation to counterfeit goods, the Fraud Operations Branch will initiate a program to be implemented by Office of Investigations Headquarters and field offices to counter the growing threat of counterfeit and trademark violations. Life and health threatening import violations will be specifically emphasized.

QUESTION: Customs has a program called Operation EXODUS which, as I understand it, is our frontline defense against the export of sensitive, U.S. high technology to the Soviet Union and its allies. According to staff, everything from military personnel carriers to Hughes helicopters to computer chips to mainframe computers for use in missile guidance have been smuggled out of the country or there have been attempts to smuggle these items to Soviet bloc countries.

Can you give the Committee a brief rundown on the type of hi-tech smuggling/EXODUS activity that is taking place in Wisconsin, Minnesota, and other parts of the upper midwest? Also give us a snapshot of what is getting by us elsewhere and what the estimated price tag is on the losses and what we are catching?

ANSWER: EXODUS activity in the upper midwest or North Central Region of the Customs Service predominantly involves U.S. manufacturers of high technology equipment located there whose products are being sought illegally by the Soviet bloc. In most instances, these manufacturers are not involved in these criminal activities, and in several recent cases, the cooperation of the manufacturers with Customs has been critical to success.

EXODUS records indicate that since October 1981, there were 329 seizures of critical technology or munitions in the 6 states of Wisconsin, Minnesota, Michigan,

Illinois, Ohio and North Dakota. The value of these seizures was approximately $7 million. Of these, Minnesota had 9 seizures valued at $272,000 while Wisconsin had only 1 seizure valued at $7,000. The largest single area was Chicago with 239 seizures valued at $5.7 million. (These seizures represent activity at the ports of exit in the upper midwest. We cannot segregate information concerning seizures of high technology from midwest manufacturers which was seized at ports in other parts of the United States.) By comparison, during the same time period there was an EXODUS total of approximately 4,000 seizures valued at $255 million.

There is no definitive means available for measuring the technology loss which we miss. Recent news articles, however, have reported an estimate, by Assistant Defense Secretary Richard Perle, that the Western technology that is obtained by the Soviet Union has driven up defense costs to the Western Alliance by the tens of billions of dollars.

Two of the most significant EXODUS cases from the midwest are the TENCOM and the COMPUTER MAINTENANCE OF MINNEAPOLIS cases. TENCOM INC. of Northbrook, Illinois, and a network of companies in the United States, Federal Republic of Germany, Italy and Libya conspired to export aircraft parts to Libya in violation of the Arms Export Control Act (AECA). $2.5 million in parts were seized, forfeited and delivered to the U.S. Air Force for use and the company was fined $4.3 million. One of the TENCOM corporate officers was sentenced to 5 years in Federal prison. In the COMPUTER MAINTENANCE case, Digital Equipment Corporation (DEC) VAX 11/780 computers were being diverted to Bulgaria. COMPUTER MAINTENANCE OF MINNEAPOLIS, St. Paul, Minnesota, 5 individuals and 3 foreign corporations were indicted for violations of the Export Administration Act (EAA). One of these individuals, Brian Williamson, has been engaged in the illegal transfer of U.S. technology for 20 years. As a result of this investigation, he and another defendant have plead guilty to violations of the export laws of the United Kingdom and have been sentenced to prison there.

QUESTION SUBMITTED BY SENATOR LOWELL P. WEICKER, JR.

QUESTION: Commissioner Von Raab, on March 21, 1985, I wrote a letter to Secretary Baker concerning the status of the Bridgeport Customs office. In that letter I pointed out that the Customs Service had not complied with the law regarding its action in the case of the Bridgeport District Customs office. To date, I have not received an answer to my letter. I would like an explanation at the earliest possible date as to why the Customs Service believes it can ignore both the letter and the spirit of the law in the case of Bridgeport, Connecticut Customs office.

ANSWER: Deputy Commissioner DeAngeles will be glad to meet with you at your convenience to discuss the circumstances concerning the Bridgeport Customs Office.

Questions Submitted by Senator Alfonse D'Amato

QUESTION: Last year, the Administration made a commitment for additional funding for the Customs Service to add 75 inspectors and 25 agents in New York, and to establish and staff an Air Unit and Marine Module to combat drug smuggling in New York. To what extent do the FY 1986 budget request and the Customs Service's own internal plans and procedures provide for the continuation of this program? How much do you expect to spend on this program in FY 1985 and 1986? Please break this down in terms of personnel salaries, operations and maintenance of equipment, asset acquisition costs, and any other category you think relevant.

ANSWER: Customs FY 1986 budget request provides funding at the same level as provided in FY 1985 for the narcotics interdiction effort in New York. This includes approximately $3 million in personnel costs and $2.5 million in equipment and maintenance costs.

QUESTION: To what specific locations have the additional personnel been assigned? Please indicate the number of personnel in place at each location.

ANSWER: In addition to the 75 inspector and 25 agents positions in New York, four pilot positions have been assigned to the New York Air Program and 13 positions have been assigned to the New York Marine Module.

QUESTION: There were to have been two helicopters and a fixed wing aircraft in the New York Air Unit. Have these assets been delivered? If not, when do you expect them to be operational? To what extent is the Air Unit making use of ground and other radars in the New York Region? To what extent has it received the assistance of the Customs Service's P-3 radar plane? What additional resources are necessary to make the Air Unit fully effective?

ANSWER: On January 15, 1985, the New York Air Unit was established. Equipment presently assigned to the unit are one Jet Ranger helicopter and one twin-engine fixed wing aircraft. The Air Unit is located at Hangar 1 MacArthur Airport Ronkonkoma, Long Island, and is currently staffed with TDY personnel. Vacancy Announcements have been circulated and when the positions are filled four pilots will be permanently assigned to the Unit. Permanent staff is expected to be onboard by June 30, 1985.

When the Air Unit is fully staffed and operational, liaison will be established with the Federal Aviation Administration (FAA) and coordinated special operations will be conducted. These operations will include airborne radar (P-3A) detection capability as well as FAA facilities. As needed, additional resources may be temporarily assigned in order to adequately address the smuggling threat. The New York Air Unit is to be managed by the Jacksonville AOB under the Director, Aviation Operations Center, East. The Director,

Aviation Operations Division, Washington, D.C., will closely monitor and review overall operations.

QUESTION: **When is the New York Marine Module expected to be operational? When will the radar ship and two chase boats be delivered? What additional resources are necessary to make the Marine Module fully effective?**

ANSWER : The New York Marine Module is expected to be operational during the latter part of September 1985. This estimate is based on delivery of the module vessels. The radar platform is scheduled for delivery in mid-September and the interceptor vessels will be delivered in July. The New York Marine Module's location, staffing, and equipping have been carefully planned and at this time no additional resources are anticipated.

QUESTION: **What steps have you taken to ensure that this entire Program succeeds? How do you evaluate this program's effectiveness to date? Do you have figures on drug seizures, arrests, indictments, and investigations made possible by this initiative?**

ANSWER : Implementation of Marine Modules is based upon up-to-date threat assessments, specific strategic and tactical intelligence, case development, productivity measurement, geographic location and management expertise. The effectiveness of the Marine Module Program's seizures, arrests, indictments, and investigations are monitored on a monthly basis.

QUESTIONS SUBMITTED BY SENATOR LAWTON CHILES

QUESTION: **The Customs Service recently completed a $455,000 "Proof of Concept" study which indicated that 360° air-to-air surveillance from an aerostat appeared to be feasible. The results would seem to indicate a potential for use of larger ballons, similar to the Goodyear "BLIMP", as a very useful weapon in surveillance and interception of air smugglers. We understand the Coast Guard is exploring this approach. Can you tell us about Customs' plans for testing such a concept?**

ANSWER : U.S. Customs plans a 6-month test of a Lighter-Than-Air (LTA) airship equipped with state-of-the art detection radar, infrared sensor package, and a communications package. Test operations will exercise the airship systems in realistic scenarios and in operational environments. If approved, this test will provide an evaluation of the operational effectiveness and suitability of the LTA airship for Customs Marine Interdiction program.

QUESTION: **It has recently been reported by the Coast Guard that cocaine smugglers have been making increased use of fast boats. Does your experience confirm this? Are the enhanced marine modules going to be able to cope with this threat?**

ANSWER : Yes, Customs experience does confirm the increasing use of fast, offshore powerboats by the smugglers, in the high threat South Florida area. The marine

modules, with vessels such as BLUE THUNDER, as well as the soon to be acquired high powered off-shore interceptors for the FY 85 modules will be able to cope with this threat.

However, the enhanced marine modules are only one portion of what must be a systematic approach to the narcotics smuggling threat. Other scheduled enhancements to the Customs Marine Program include acquisition of fully sensored aircraft, maximum use of the three existing tethered aerostats, and use of beacons/transponders covertly installed on suspect vessels.

SUBCOMMITTEE RECESS

Senator ABDNOR. With all of that, I want to thank you for being with us today and if there is no further business to come before the subcommitte, we stand in recess until 2 p.m. on Tuesday, April 23 when we will hear from public witnesses.

[Whereupon, at 11:50 a.m., Wednesday, April 17, the subcommittee was recessed, to reconvene at 2 p.m., Tuesday, April 23.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

TUESDAY, APRIL 23, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:15 p.m., in room SD-138, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor and Mattingly.

NONDEPARTMENTAL WITNESSES

THE AMERICAN LEGION

STATEMENT OF JOSEPH MILLER, DIRECTOR

Senator ABDNOR. The subcommittee will come to order.

Sorry we are off to a late start. I was at another meeting and I had difficulty getting out.

Today we will continue our fiscal year 1986 hearings and we will hear testimony from public witnesses. Now we have a number of witnesses, and unfortunately, we do not have all of the time we would like to have. In order to hear all of the testimony today, I would ask each of our witnesses to limit statements to 5 minutes. To assure your points are made, I want you to know that the entire text of each statement will be made a part of the record for the committee to review.

I am sorry that my ranking minority Senator, Senator DeConcini, through no fault of his own could not be here. We will call on his assistant, Bob Mills.

We will start today's hearing with a panel of witnesses from various organizations concerned with subsidy for forgone revenue. Also, at this point I ask that a statement in the form of a letter from Senator Robert Byrd be put in the record.

[The information follows:]

LETTER FROM SENATOR ROBERT C. BYRD

MARCH 29, 1985

Hon. JAMES ABDNOR,
Chairman, Subcommittee on Treasury, Postal Service and General Government, U.S. Senate, Committee on Appropriations, Washington, DC

DEAR MR. CHAIRMAN: I hope that the U.S. Postal Service continues to maintain small rural post offices and 6-day postal delivery service. In the past, the Postmaster General has indicated to the Senate Appropriations Committee his willingness to participate in economies—but pledged not to close small rural post offices or eliminate 6-day mail delivery service in the process.

Because these postal service matters are so important to rural States, such as those you and I represent, I urge that the subcommittee include an amendment in the bill which would prohibit the use of appropriated funds to close small post offices or discontinue 6-day mail delivery service.

I also hope that the Port of Customs office in Charleston, WV, will be maintained and that no action be taken by the Treasury Department to close or reduce the operations at this office. Report language to this effect would be appreciated.

The Parkersburg, WV, facility of the Bureau of the Public Debt maintains operations relating principally to U.S. savings bonds. Because of allegedly declining workloads, the staffing level at this facility has been reduced from 963 in fiscal year 1985 to 949 in fiscal year 1986. In the past, I had been advised that the Treasury Department was looking into the possibility of moving some Washington-based functions to Parkersburg over a period of years to take advantage of existing space and the excellent-quality work force in Parkersburg. Consequently, I am again this year recommending that language be included in the committee report which would accelerate and expedite the review of the relationship between the work force at Parkersburg and the work force at headquarters with a view to shifting functions to the Parkersburg facility to make maximum use of existing space and staff. I am also recommending that a progress report on the review be submitted to the committee prior to January 20, 1986.

I am further concerned that taxpayer services and counseling for the elderly not be reduced, but rather be maintained in fiscal year 1986 at the level provided by the committee for fiscal year 1985.

Thank you for your cooperation. I would appreciate if this letter were made a part of the hearing record.

Sincerely yours,

ROBERT C. BYRD.

Senator ABDNOR. Mr. Joe Miller will be here representing the American Legion; Clyde E. Shorey, representing the Alliance of Nonprofit Mailers; Mr. Boyd Rooney representing the National Association of Public Television Stations; and James Gashel of the National Federation of the Blind; and J. Scott Marshall, of the American Council of the blind.

Mr. Miller will be the lead off witness.

Mr. MILLER. Mr. Chairman, thank you.

Mr. Chairman and members of the subcommittee, the American Legion welcomes this opportunity to present its views relative to the appropriations for the revenue forgone postal subsidy for the upcoming fiscal year.

Before we proceed with our statement, we would like to take a moment and thank this subcommittee for its leadership in supporting the necessary appropriations to maintain nonprofit postage rate stability over the last several years. Because of this subcommittee's leadership, preferred rate mailers have enjoyed the longest period of stabilized postage rates since the enactment of the Postal Reorganization Act of 1970.

This year it is estimated by the USPS that to keep nonprofit postal rates at their current level during fiscal year 1986, an appropriation of $980 million will be necessary. Slightly more than $1 billion would be required if the rates were rolled back to their pre-February 15, 1985, levels. Last year we came before you and explained our reasons for seeking an additional year of stabilization. We explained that we would not oppose an orderly phasein of higher rates, provided that our State and local units had time to accommodate those rates.

The Legion has recognized for some time that an ever increasing Federal deficit is a situation which threatens the survival of this Nation. It is equally clear that unless something is done, the deficit will exceed $225 billion during the upcoming fiscal year. We also know that by continually asking for more money to support the subsidy, we are compounding the difficult decisions that this subcommittee must make regarding the allocation of available revenues. Thus, this subcommittee and nonprofit organizations are faced with the conundrum of how to apportion an ever decreasing level of revenues among what appears to be equally desirable programs.

Mr. Chairman, I would like to point out a couple of facts. One, there are 880,000 tax exempt organizations. That is 5,760 more than were listed in 1983. Since 1981, the number of tax exempt organizations has increased by 20,212. Of this total number, more than 180,000 are authorized—have subsidized mail rates.

The conundrum that we spoke of earlier makes it clear that the ever declining subsidy envisioned by the Congress, during the development of the Postal Reorganization Act of 1970, has not become a reality. While the percentage increase is certainly modest, the effect on the subsidy has to be measured in conjunction with other associated factors. These factors include increased mail usage by nonprofits, increased USPS handling costs and the increased weight of individual pieces being mailed. We also think that the subcommittee ought to direct its attention to sweepstakes, promotions, insurance sales, and travel programs mailed at preferred rates which may contribute significantly to the increased level of revenues required to subsidize the mail programs of nonprofit organizations. Because such mail is now routine, the question must be asked, is this the type of mail that Congress intended to subsidize?

With the proliferation of nonprofit organizations has also come an escalation in the funding necessary to repay the U.S. Postal Service for the cost of free and reduced rate mail. These figures are in our statement and we invite you to look at them.

The American Legion has developed a legislative proposal that would in part correct some of the problems. This legislation would require: One, a community service standard in order to be eligible to receive the benefit of nonprofit mail; two, provide a vehicle whereby Congress would determine the various cost factors that should be included in evaluating postal rates for nonprofit mailers; and three, would require that Congress, and not the Board of Governors of the U.S. Postal Serv-

ice, or the Postal Rate Commission, determine what rates nonprofit mail should carry.

Further, all organizations would clearly retain any eligibility providing certain minimum public service criteria are met. These same organizations would then be required to demonstrate a direct and measurable public service benefit within 9 months to 1 year of their date of grandfathering. I would like to emphasize, the legislation does not establish the criteria or eliminate organizations. Instead, the proposal leaves to Congress, the U. S. Postal Service, and the IRS, the job of determining and setting up community service standards. However, because many organizations now using the subsidy would no longer be eligible for the benefit because they are not measurably contributing to the public welfare and because certain types of currently routine mail would no longer be eligible for preferred rates, the level of Federal subsidy needed to support nonprofit rates would be greatly reduced without any loss in public benefit.

PREPARED STATEMENT

Mr. Chairman, that concludes our statement and we will be happy to respond to any questions that you may have.

Senator ABDNOR. Thank you, Mr. Miller.

We appreciate anything you can help us with.

[The statement follows:]

STATEMENT OF JOHN E. MILLER, JR.

Mr. Chairman and Members of the Subcommittee, The American Legion welcomes this opportunity to present its views relative to the appropriations for the Revenue Foregone postal subsidy for the upcoming fiscal year.

Before we proceed with our statement we would like to take a moment and thank this Subcommittee for its leadership in supporting the necessary appropriations to maintain non-profit postage rate stability over the last several years. Because of this Subcommittee's leadership preferred rate mailers have enjoyed the longest period of stabilized postage rates since the enactment of the Postal Reorganization Act of 1970. This prolonged period of stabilization has enabled the Legion and many other worthwhile non-profit groups to continue their community based volunteer services and programs uninterupted. The period of stabilization has also allowed our more than 16,000 community based Posts in the 50 Legion Departments to plan for future postage rate increases in an orderly fashion and with a minimum impact on their community based volunteer activities.

Over the last several years we have provided this Subcommittee with a variety of documents which demonstrate the level of volunteer activity performed by the Legion in its efforts to assist Americans and communities in need. This year, as in years past, we would like to have entered for the record a copy of the Legion's most recent Consolidated Posts Report which indicates that our organization has increased its volunteer activity beyond the level reported last year. This increase is due, in large part, to a postal subsidy that enables Legion posts around the country to communicate with the membership at the grass roots level. As you know, the mail is the primary means used by the Legion to communicate between all levels of Legion activity. Because of this, the Legion is acutely aware that unanticipated increases in the cost of postage and related items can, translate into less frequent communication. Depending upon the type of mail involved, less frequent communication might

negatively impact on the volunteer services available to citizens and communities in need.

This year it is estimated by the U.S.P.S. that to keep non-profit postal rates at their current level during FY 86 an appropriation of $980 million will be necessary. Slightly more than $1 billion would be required if the rates were rolled back to their pre-February 15, 1985 levels. Last year we came before you and explained our reasons for seeking an additional year of stabilization. We explained that we would not oppose an orderly phase in of higher rates, provided that our state and local units had time to accommodate those rates.

The Legion has recognized for some time that an ever increasing federal deficit is a situation which threatens the survival of this nation. It is equally clear that unless something is done the deficit will exceed $225 billion during the up coming fiscal year. We also know that by continually asking for more money to support the subsidy we are compounding the difficult decisions that this Subcommittee must make regarding the allocation of available revenues. Thus, this Subcommittee and non-profit organizations are faced with the conundrum of how to apportion an ever decreasing level of revenues among what appears to equally desirable programs.

This conundrum makes it clear that the ever declining subsidy envisioned by the Congress, during the development of the Postal Reorganization Act of 1970, has not become a reality. Instead there are 871,224 tax exempt organizations listed with the Internal Revenue Service, 5760 more than were listed in 1983. Since 1981 the number of tax exempt organizations has increased by 20,212 from 851,012 to 871,224 at present. While the percentage increase is certainly modest, the effect on the subsidy has to be measured in conjunction with other associated factors. These factors include increased mail usuage by non-profits, increased USPS handling costs and the increased weight of individual pieces being mailed. For example, sweepstakes, promotions, insurance sales, and travel programs mailed at preferred rates may contribute significantly to the increased level of revenues re-

quired to subsidize the mail programs of non-profit organizations. Because such mail is now routine the question must be asked is this the type of mail that Congress intended to subsidize?

With the proliferation of non-profit organizations has also come an escalation in the funding necessary to repay the U.S. Postal Service for the cost of free and reduced rate mail. For example, non-profit organizations spent $566.1 million on preferred rate postage in 1983 and $638.4 million in 1984. Thus, with rates stable, non-profits increased their mail programs by $72.3 million. During the same timespan the subsidy increased by $95.3 million. Costs for blind and handicapped mailings must also be added, totals of $20.5 million in FY 83 and $50.5 million in FY 84. Thus, with nearly a million organizations currently eligible for preferred mail rates there is little question in our mind that Congress is going to have to decide just what type of mail is going to qualify for subsidization.

The Administration has posed a possible solution to the problem of subsidized mail rates in its FY 86 budget request. Their proposal would create a cross subsidy between commercial rate and preferred rate mailers would be required to pay more so that preferred rate mailers would be required to pay less. Aside from some of the more obvious legal questions involved in the issue of cross subsidization there is the question of competitive advantage. This position holds that since many non-profit organizations use the subsidy in ways that are de facto competitive with commercial mailers, such as insurance sales and travel programs, a cross subsidy would force commercial rate mailers to underwrite their competitors. We view such a proposal with alarm because it sets the stage for small or declining organizations to demand that their efforts be underwritten by larger and more effective operations.

It is, of course, true that cross subsidies already exist for such worthwhile programs as public transportation. However, these cross subsidies are not truely analogus to the situation where one class of mailer is required to underwrite, in essence is forced to donate to the efforts of, another class of mailer despite the commercial disadvantage of such forced contribution.

The Legion feels that contributions to non-profit activities should be voluntary since voluntary donations allow individuals and organizations to demonstrate their preference, and support, for the charitable activity of their choice.

We recognize that proposing a legislative remedy for the Revenue Foregone postal subsidy is beyond the scope of this hearing and that this Subcommittee is going to have to allocate the funds available to it where they will do the most good. However, it is our opinion that non-profit activity results in less, not more, Federal outlays and that government programs which encourage, and assist in perpetuating, non-profit volunteer activity, such as the Revenue Foregone postal subsidy, are indeed worthwhile expenditures for the Congress to make. Because of this, and since the Legion is desirous of perpetuating the subsidy as a much needed and cost effective resource for the non-profit community, it has developed legislation to remedy the problems mentioned earlier. This legislation would require:

I. a community service standard in order to be eligible to receive the benefit of non-profit mail;

II. provide a vehicle whereby Congress would determine the various cost factors that should be included in evaluating postal rates for non-profit mailers; and

III. would require that Congress, and not the Board of Governors of the U.S. Postal Service or the Postal Rate Commission, determine what rates non-profit mail should carry.

Further, all organizations would clearly retain any eligibility providing certain minimum public service criteria are met. These same organizations would then be required to demonstrate a direct and measurable public service benefit within nine months to one year of their date of grandfathering. The legislation does not establish the criteria or eliminate organizations; instead, the proposal leaves to Congress, the U.S. Postal Service and the IRS the job of determining and setting up community service standards. However, because many organizations now using the subsidy would no longer be eligible for the benefit because they are not measurably contributing to the public welfare and because certain types of currently routine mail would no longer be eligible for preferred rates, the level of federal subsidy needed to support non-profit rates would be greatly reduced without any loss in public benefit.

AMERICAN LEGION POSTS - 1983 CONSOLIDATED REPORTS NATIONAL SUMMARY

General	1980-81	1981-82	1982-83
Membership current year (as of reporting date)	1,530,377	1,602,593	1,493,834
Membership past year (final)	1,541,064	1,626,653	1,530,741
New members initiated	40,806	37,960	35,297
Net assets	$497,682,675	$629,775,063	$552,972,133
IRS Form 990 filed	3,780	3,975	3,854
Post home owned debt free	3,354	3,589	3,453
Post home owned with debt	1,001	1,020	1,024
Post home rented	514	534	504
No cost for Post home	668	753	564
Other arrangement for Post home or meeting place	356	365	340
Rehabilitation			
Rehabilitation cases handled	286,395	471,766	258,195
Powers of attorney granted	50,211	63,832	44,495
Cash aid given veterans	$685,245	$848,115	$790,555
VAVS hours donated	888,640	1,018,754	965,109
Contributions to VAVS program (new 1982-83 category)	-	-	$777,502
Posts with Veterans Affairs and Rehabilitation Committee	1,359	1,462	1,426
Posts with Service Officer	5,325	5,667	5,452
Operation Post Home	2,131	2,320	2,248
National Security			
Pints of blood given	105,692	112,509	301,793
Legion blood donors	58,755	59,918	59,576
ROTC medals given	3,585	3,891	5,245
Posts with crime resistance program	786	971	957
Posts working with Red Cross in disaster relief (new 1981-82 cat.)	-	1,025	1,023
Public Relations			
Posts with Public Relations Chairman	3,539	3,812	3,580
Posts with regular paper or bulletin	2,776	2,910	2,773
Communications by cable television	358	444	494
Communications by radio	1,851	2,060	2,004
Communications by television	376	452	468
Communications by press	3,585	4,035	3,651
Posts with ¼" VHS player/recorder (new 1982-83 category)	-	-	504
Uniformed Groups			
Posts sponsoring color guard	3,505	3,779	3,622
Posts sponsoring firing squad	3,243	3,451	3,314
Posts sponsoring drum and bugle corps	174	180	166
Posts sponsoring band	149	156	149
Posts sponsoring drill team	337	364	373
Posts sponsoring other uniformed groups	229	269	276
Cost of uniformed groups	$1,646,978	$1,505,759	$1,567,492
Economic			
Posts with veterans employment program	1,138	1,142	1,101
Veterans assisted with finding jobs or training	33,785	26,874	20,412
Americanism			
Boys State			
Boys sponsored	15,615	16,979	16,110
Posts participating in Boys State	4,987	5,356	5,083
Cost of sending boys	$1,510,459	$1,762,506	$1,740,851
Baseball			
American Legion Baseball teams	2,037	2,127	2,033
Other athletic teams sponsored	2,295	2,321	2,314
Cost of all athletic teams	$5,261,977	$5,984,372	$5,339,433

Americanism (cont.)	1980-81	1981-82	1982-83
Boy Scouts			
Boy Scout units sponsored by Posts	1,392	1,458	1,418
Scouts in Legion-sponsored units	36,527	38,316	33,854
Legionnaires active in Scouts	6,177	7,757	7,747
Cost to Posts	$409,404	$466,551	$576,475
School Awards			
School awards granted	19,394	21,050	20,482
Posts making awards	3,316	3,481	3,339
Cost of awards	$323,342	$361,773	$381,464
Oratorical Contest			
Posts active in program	1,092	1,236	1,099
Youths competing	4,676	5,119	4,897
Cost to Posts	$88,604	$112,586	$120,693
Education and Scholarships			
Number of scholarships awarded (new 1982-83 category)	-	-	3,336
Cost of scholarships	$765,661	$830,284	$916,823
Patriotic Events			
Posts observing Veterans Day	4,772	5,198	4,988
Posts observing Memorial Day	5,997	6,527	6,268
Posts observing July 4	3,339	3,578	3,545
Posts observing Legion birthday	4,708	5,002	4,843
Posts observing American Education Week	1,141	1,181	1,207
Posts observing Four Chaplains Sunday (new 1982-83 category)	-	-	1,321
Community Service			
Hours given to community service	2,707,206	2,807,136	3,163,901
Posts reporting community service	4,279	4,532	4,206
Special Olympics			
Special children aided	17,567	21,937	23,235
Posts participating in program (new 1981-82 category)	-	855	848
Cost to Posts	$306,637	$330,138	$406,390
Children and Youth			
Cash aid given to children and youth	$876,583	$939,392	$1,110,053
Value of goods given to children and youth	$1,290,763	$1,288,442	$1,468,864
Cost of extras (parties, gifts)	$1,493,149	$1,718,580	$1,718,456
Cost of other activities to benefit children	$1,053,729	$1,388,898	$1,066,213
Children given direct aid	184,042	175,673	168,009
Children benefitted in other ways	556,854	677,968	785,890
Contributions			
Mental health	$90,653	$123,459	$92,679
United Fund	$140,560	$160,784	$140,695
Retarded children	$317,772	$321,986	$334,398
Red Cross	$81,941	$91,224	$100,869
American Legion Child Welfare Found.	$38,104	$41,012	$31,867
Cancer	$163,183	$141,644	$120,260
Other contributions	$1,650,527	$2,027,809	$2,043,526
Crippled children	$209,577	$219,270	$236,182
Legislative			
Posts with active Legislative Chairman	2,185	2,334	2,197
Posts subscribing to National Legislative Bulletin	1,316	1,448	1,356
Energy			
Posts with Energy Committee	1,379	1,323	1,238
Percentage of all Posts reporting	43.14%	47.78%	45.01%

ALLIANCE OF NONPROFIT MAILERS

STATEMENT OF CLYDE E. SHOREY, CHAIRMAN

Senator ABDNOR. Next is Clyde Shorey.

Mr. SHOREY. Mr. Chairman, thank you.

I am Clyde Shorey of the March of Dimes and also president of the Alliance of Nonprofit Mailers. The alliance is made up of over 60 of the largest nonprofit mailers, all of whom are well-known to the public at large and represent a very substantial portion of the third-class nonprofit mail.

I am joined by Roberta Van Beek of the Easter Seals Society.

Senator ABDNOR. Welcome.

Mr. SHOREY. Under the Postal Reorganization Act the amount that is required to fund the preferred rate mailers, nonprofit mailers, as required by law, is in the vicinity of $960 to $980 million. This compares to a figure of $801 million for last year. The reason for the increase is due to the fact that all mail was increased on February 15 of this year due to the recent postal rate case and across-the-board postal rate increases. Increases in the rates have resulted in the amount of subsidy that is required.

An event of great importance this year is that for the first time the administration has recognized the fact that this subsidy is important and should be covered in full, even though they are now suggesting that this be done by shifting the costs from the Federal Government to other mailers. In any event, the important point is that the administration has now recognized that the continuation of the subsidy is of major importance.

I do not have to tell you of the important services that the nonprofit community performs for the public. I have done so in previous years in my testimony before you. It is included in my statement in full.

What has happened is that on February 15 of this year all postal rates increased, including the nonprofit rate. We went from an all other rate of 5.2 cents to 6 cents. That is a 15-percent increase. In order to hold that rate as required by the Organization Act, I have already told you the amount of funds that would be required to continue. That would require in July 1986 an increase to 6.7 cents for that same mail. That is another 12-percent increase over the existing rate.

So even with the authorized level of funding that we are talking about, there would be close to a 30-percent increase for nonprofit mailers during the 1986 fiscal year. If the funding were continued at last year's level of $801 million, that would require the rate to go immediately, October 1, to 7.3 cents, which is a 22-percent increase over the existing rate and a 40-percent increase over the rate that existed in February. That is, the nonprofits would be required to pay 40 percent more on October 1 than they were paying in February.

If, however, the proposal of the administration to reduce the subsidy to zero is followed, this is also accompanied, as I mentioned, by their recommendation to shift the burden of the subsidy to the other mailers,

which would require a change in the Postal Reorganization Act. It would require a change in the authorizing legislation. Frankly, that is not going to happen this year because all of the mailers, and even the nonprofit mailers, are opposed to such a move. I wouldn't go into the details about why that is so, but this is the case.

As a matter of fact, it is obvious why they are opposed to it, because they would have to pick up the additional cost, which is estimated to be at least 1 cent on first-class rates. As I see it, there is no chance of passing that by October 1, and, therefore, if the administration proposal to reduce it to zero goes into effect, there would be no subsidy to pay the cost, the differential, for nonprofit mailers, and our rate would then go to 12.5 cents. That is a 140-percent increase, which means that the nonprofit mailers would be paying 2½ times as much in October of this year than they were paying in February, and that means that the budget for the March of Dimes would go from $6 to $15 million. You can see what that would do to the programs that we are performing in the area of the prevention of birth defects. To be reduced by that amount of money would be devastating to those programs.

It would actually mean $981 million would have to be paid by the nonprofit community that is currently not being paid. The full amount of the subsidy would have to be picked up by that community.

So, Mr. Chairman, we are asking you, this committee, to carry out an appropriation. We are asking that the amount be the amount that is authorized in the statute, because even with that, we will have very substantial rate increases between February of this year and October 1.

Thank you.

PREPARED STATEMENT

Senator ABDNOR. Thank you. We will place your statement in the record.

[The statement follows:]

STATEMENT OF CLYDE E. SHOREY

Mr. Chairman and Members of the Committee: My name is Clyde E. Shorey, Jr. and I am submitting this testimony on behalf of the Alliance of NonProfit Mailers.

In 1970, the Postal Reorganization Act was passed by Congress. It was intended in the Act that Congress would preserve the nonprofit postal rate following reorganization of the federal postal system. Congress believed that the federal government has a responsibility to assist nonprofit organizations in their efforts to provide programs and services to all Americans. As a matter of fact, President Reagan, in his 1981 inaugural address stated:

> Those who say that we're in a time when there are no heroes -- they just don't know where to look.... There are individuals and families whose taxes support the government and whose voluntary gifts support church, charity, culture, art and education. Their patriotism is quiet but deep. Their values sustain our national life.

The President's proposals regarding revenue foregone appropriations for FY '86 clearly run counter to his eloquent statement in support of causes that the preferred mailing rates underwrite.

The amount necessary to fund this program at the legally mandated level of funding is $981 million for FY '86. This would maintain rates at their current level of 6.0 cents per piece for required presort until July 1986, when the rates will increase to 6.7 cents per piece. This is the phasing schedule, as amended in 1974, that was mandated by the Postal Reorganization Act. The President has repeatedly sought to undermine the intent of the Act by either proposing insufficient or no funding at all for revenue foregone. This represents a direct blow to the many charitable organizations who rely on nonprofit mail to disseminate information about their programs and services and to raise funds.

Earlier, there was a reference to the President's inaugural address in 1981 and his well-phrased speech asking that the private sector pick up programs and services that the government would no longer be able to fund. It is important to point out that the postal subsidy represents a very small investment on the part of the government, in return for the programs and services provided last year alone by charitable organizations across the country. As a matter of fact, charities last year raised in excess of $66 billion for programs and services, in major part made possible by the reduced mailing rate for charitable organizations. The appropriation for revenue foregone in FY '85 is $801 million, quite a return on the government's investment.

It is important to note at the outset that nonprofits are already paying a higher postal rate as a result of the general postal rate increase that went into effect on February 17, 1985. If the President's proposal to eliminate federal funding for revenue foregone were approved, the current 6.0 cents rate would jump to 12.5 cents on October 1, 1985. This is money that can only come from the program and services accounts of these nonprofit organizations. For example, the combined Catholic charities mail approximately 600 million pieces a year; an increase to 12.5 cents on October 1 will mean that they will spend an additional $44 million that will no longer be available for programs in the communities across America. On a smaller scale, but no less important, the New York State Division of the American Cancer Society currently sends out 400,000 pieces of mail, four times a year. Prior to February 17, 1985, for the 1984 calendar year the Division spent roughly $83,200 for postage. The recent rate increase will increase postage costs to $96,000 for 1985. If the rate jumps to 12.5 cents on October 1, 1985, the postage costs will jump to over $200,000 per year. The Administration's proposal, a 12.5 cents rate, in effect would mean that nonprofits would experience 140% more in postage costs over a nine-month

period. There is no doubt that if the President's proposal was adopted, the ACS would be forced to cutback some of its programs in the community and quite possibly completely eliminate others.

The New York State Division of the American Cancer Society operates a Hope Lodge Program in four major cities in the state. These lodges house approximately 250 patients a year and members of their families for an average stay of five weeks. These cancer patients are receiving radiation or other types of treatment at nearby hospitals. These patients, for the most part, are aged, infirmed and poor patients who otherwise could not afford to pay out of their pockets the $40-75 per night that a motel would charge to house them or their families. This invaluable and necessary service to cancer patients, free of charge to them, costs the New York State Division about $150,000 per year to operate. If revenue foregone were eliminated and the rate increased to 12.5 cents per piece, the Hope Lodge program would have to be cut back and possibly eliminated.

The last line in the President's budget message regarding revenue foregone states an endorsement for continuation of preferred rates. However, as was pointed out earlier, the Administration designates no federal funds for revenue foregone. Instead it proposes to fund through cross-subsidization of all classes of mail. Basically, it is difficult to understand how one class of mailers should be forced to subsidize another. This would fly directly in the face of the reform that the Congress approved in 1970. In addition, if the commercial bulk-rate mailers had a substantive rate increase due to cross-subsidization, they could be forced away from the Postal Service, and thus create what could be a serious negative volume impact and loss of income to the service, possibly driving rates even higher.

It is important to note that to accomplish the goals set out in the Administration's proposal, a change in the present law would be required. Such an effort would be very controversial and most unlikely to succeed; a considerable amount of time could be spent on this issue with failure the most probable outcome.

The preferred rate was established by law many years ago, and its rationale is equally justified today.

All of the nonprofit mailers have projected their fiscal year 1986 Budgets on the basis of present law. Thus, we request that $981 million be provided through congressional appropriations.

Recognizing the need for some thoughtful research on a complex subject of such vital importance to the nonprofit sector, early in 1984 the Alliance invited a distinguished panel of individuals chaired by The Honorable Gale McGee and including the Executive Director of the American Association of Retired Persons, Mr. Cyril F. Brickfield; former Postmaster General, The Honorable J. Edward Day; the President of the National Catholic Development Conference and Director of the Marianist Mission in Dayton, Ohio, The Rev. Richard Knuge; and the Honorable James M. Hanley, former Chairman of the House Post Office and Civil Service Committee. They were appointed to review the entire situation in view of history, experience and knowledge of both the legislative and the executive process. This group was unique in the depth and breadth of experience of its members in the nonprofit area. Their charge was to determine the rationale for the continuation of using general revenues for this purpose. After five months of exhaustive effort, the report was finalized in January of this year and is attached to this testimony today. It leaves no question or doubt about revenue foregone being an excellent investment of taxpayer's money. I request that the report be contained in the record today.

Senator ABDNOR. Thank you. Do you have any comment you want to add?

The gentlemen you see on my left and right are the head staffers of this committee. This is Mr. Parkinson, and Mr. Mills is Senator DeConcini's staffer. He has a special interest in the next witness as he comes from Arizona and I have asked him to introduce him.

Mr. MILLS. Thank you.

Keeping with this subcommittee's truth in Government policy, let the truth be known that Senator DeConcini fell in his back yard last night and cracked his ankle, so he is, I believe, still out at the hospital having a walking cast or a limping cast put on it, so he was unable to be here. But he had prepared a statement to introduce Mr. Boyd Rooney, and the chairman has been kind enough to ask me to read it into the record.

Mr. MILLS. I am pleased to introduce Boyd Rooney to this subcommittee. Boyd Rooney is general manager of KUAT-TV as well as KUAT-AM and FM radio stations. He is also president of the Pacific Mountain Network, an organization of public television stations. KUAT has done a remarkable job under Boyd's stewardship, and it has been in the forefront of innovative programming proving popular in the Tucson television market.

"Arizona Illustrated" is a nightly news magazine. This program provides an in-depth analysis that goes beyond the network news to look at issues of importance to Tucson and southern Arizona.

"Arizona Illustrate" and other exciting programming has resulted in high ratings for KUAT-TV. In fact, the station consistently ranks in the top 10 public television stations in the country based on viewership. Likewise, the AM and FM radio stations also rank high in these ratings. All of this has resulted in a loyal and interested audience. KUAT television and radio have very successful membership drives and benefit from strong support from the local community.

The Senator welcomes Boyd to this morning's hearing and we look forward to hearing his thoughts.

NATIONAL ASSOCIATION OF PUBLIC TELEVISION STATIONS

STATEMENT OF BOYD ROONEY

Mr. ROONEY. Thank you very much.

I am here representing the National Association of Public Television Stations and I would like to submit my statement for the record.

Senator ABDNOR. Without objection, all statements will be submitted for the record.

Mr. ROONEY. This Nation's public television stations are all nonprofit, noncommercial operations that rely on the Postal Service. We are heavy users of second-, third-, and fourth-class nonprofit mail. We use that for program guides to allow our listeners to know what our programming is. Partly we use the mail for fund solicitations to solicit funds for our stations and we use the mail to ship tapes and printed materials to the schools and school children of our listening and viewing areas.

The proposed discontinuance of the forgone subsidy means approximately $4.78 million to public television stations in this country combined. If you add in the public radio stations of the country, I would expect that it would well exceed the $5 million range. I ask the question where is this money to come from? As one who is in the business of producing radio and television programs, I fear that that money may have to come in the case of public broadcasting from our programming production funds. We have already, in recent years, due to declines in Federal funding, reduced about as much as we can possibly in all areas.

Let me give you a few specifics about our situation in Arizona. We spend over $4,000 a year shipping tape and film to the schools and other stations in our area. We spend $2,800 shipping our program guide for radio to the more than 4,500 members who contribute to our radio stations and doubling that rate would increase our total costs by 20 percent. In other words, if this subsidy is removed, 20 percent of our total budget for doing our program guide will go to postage alone.

We are at the present time considering instituting a television program guide. In the case of television, we have around 15,000 members and if we do produce 12 issues, it will result in 180,000 pieces of mail additionally. That could bring in a budget approaching $12,000 if the rates increase as they would with the subsidy removed. The cost for the postage would approach $25,000 and I can tell you right now that this particular situation is very much in consideration as to whether or not we do the television program guide at a postage of $25,000 a year. I can tell you that we will not be able to do that.

In the area of fundraising and development activity, we get our contributors through two different avenues. One is our on air activity. The other is mail. Some people respond to one. Some the other. But I can tell you that once we have a dues paying member of our station, we keep them through the mails. We mail to our membership approximately 140,000 letters each year at a cost of $6,500 in postage. Over the year our entire development activity mail is slightly over 250,000 for a postage bill of approaching $12,000 a year.

The importance of this, particularly on direct mail to people who are not now members of our stations, I cite as an example last May we failed one 14,000 piece mailing and that brought us $54,000 in membership revenue. So it is very important to our total development activity to use the mails and to use the mails at a rate that makes it feasible for us to do so.

I would like to make one last point. We, in public broadcasting, feel quite strongly that we are in the business of providing significant programming for children. Just before this hearing began I was talking with Laurie Settlemyer. She said she is from the what's new generation, a program called "What's New in the Early 1960's." There are now "Sesame Street," "3–2–1 Contact," and "The Electric Company." They are making a significant impact on America's youth. They publish magazines often, as what you see here. It costs that child or that child's parent $10 to $12. We know in Arizona there are 15,000 or 16,000 children

receiving one or more of these magazines. Multiply that by all of the other States in the Union and I think you will see a significant use of the mails, and certainly the nonprofit postage subsidy that deliver these to the children. On behalf of our children I urge you to continue the subsidy.

One final statement, Mr. Chairman. At a time when this body and the administration is mandating that we earn more of our own keep, if you will, by decreasing our dependence on Federal funding, I urge you not to make our task more difficult. I can assure you that it is difficult enough as it is. I urge you to continue the nonprofit postal subsidy.

If you have any questions, I will be happy to respond.

Senator ABDNOR. Thank you, Mr. Rooney.

PREPARED STATEMENT

We are very pleased with our public television in South Dakota. I had a part in that when I was a State senator.

[The statement follows:]

STATEMENT OF PETER M. FANNON, PRESIDENT, NATIONAL ASSOCIATION OF PUBLIC TELEVISION STATIONS

This nation's public television stations--all non-profit, non-commercial operations--rely on the postal service as a vital means of communication with their viewers and supporters. Heavy users of second, third, and fourth class non-profit postal rates, our stations use this mail to supplement the educational, cultural, and fundraising efforts they provide on the air. Program guides, fund solicitations, and tape and printed material for schools are all sent by public television stations using the non-profit federal postal subsidy. Indeed, with the proposed discontinuance of the federal revenue foregone subsidy for non-profit mailers, the estimated $4.78 million that our stations would have to find elsewhere would result in cuts in their individual programming schedules and other services.

As a reaction of loyal viewers to serious cutbacks in federal funding and as a result of better fundraising techniques, subscriber support is currently the fastest growing sector of public television's income. Between 1981 and 1983, public television's income from subscription increased 35%. Subscription income now comprises the largest share of support for public television and radio stations. For public television, 20.3% of its total operating funds, or over $146 million, comes from individual subscribers. In addition, our stations are reporting all-time records for the recently-concluded March Festival fundraising in terms of the total number of viewer pledges, total dollars pledged, and the size of the average gift. These record levels were achieved despite the reduction of on-air fundraising hours by some stations in response to viewer request. What this has meant, and will continue to mean, is a growing reliance on reasonable second and third class non-profit postal rates for fundraising purposes.

Our stations' fundraising efforts do not stop when the pledge phone rings or the auction item sells. Each pledge or winning bid must be followed up with letters to secure the contributions promised over the telephone during these on-air television appeals. In FY1984, public television stations spent an estimated $2.7 million for fundraising solicitation mail on about 43 million solicitations and

follow-up materials mailed at the third class non-profit rates. (See attached chart.)

Our stations also use direct mail fund raising solicitations within their own television coverage areas--usually about a 50 mile radius. One-sixth of all the new subscribers to public television contribute in response to these direct mail solicitations. The dramatic increases in postal rates that we have swallowed in the past two years caused major problems, particularly for our smaller stations. These increases do not "pay for themselves" with more successful mailings in most non-urban areas. Since they do not mail outside their own coverage areas, stations cannot increase their contributor base. Thus, cost increases usually translate into reductions of funds available for other activities.

Crucial to fulfilling our federal mandate and maintaining our viewer support is the mailing of station program magazines and viewer guides. They are the primary means of keeping viewers informed, as well as meeting the requirements of the Public Broadcasting Act of 1967 to develop public awareness of and disseminate information about public telecommunications services. Public television stations mail over 45 million guides to viewers annually, at a cost in postage of $2.5 million. Increases in second class postal rates caused a number of stations to switch to third class mail for their monthly program information bulletins and guides. Although less expensive, third class mail is less reliable for the delivery of such time-sensitive material. Our stations make a sacrifice either way--they pay more and make adjustments elsewhere or take the lower rate and hope for timely delivery.

Public television stations are also heavy users of fourth class mail, sending virtually thousands of audio and video tapes and printed materials to schools and to other stations. Over 200 of our stations provide instructional programming to elementary and secondary schools. Around 600,000 teachers annually receive necessary schedules, teacher guides, and instructional television newsletters sent at the fourth class rate. Overall, we estimate that nearly four million mailings are affected by fourth class increases, adding another $500,000 cost to our total.

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While many of our larger stations would be hit hard by the doubling of postal costs that would result from the elimination of postal subsidies, our smaller stations will be hurt even more. As an example, the **South Dakota Network** currently spends $900 per month to send out 18,000 program guides in their state, for a total cost last year of $10,800. In addition, they sent out 129,926 pieces of direct and follow-up fund raising mail last year for $6,756. If their total mail cost doubles to $35,112 in the next year, they will be hard pressed to find enough money in another part of the Network's budget merely to match the volume of mail sent out last year.

What can $17,000 buy for the **South Dakota Network**? The producer of almost 300 hours per year of local programming, the network could use that amount to produce four months of any one of their weekly hour-long programs--Midwest Market Analysis, the call-in programs Agline and Garden Line, or the public affairs program Statehouse.

In terms of national programs, $17,000 means a half a year's worth of Sesame Street or all of Mister Rogers' Neighborhood for a year. It could pay for one-third of the McNeil-Lehrer Newshour for a year or all of Wall Street Week for two years.

The effects of increased non-profit postal rates would be devastating to one of our youngest stations, one and one-half-year-old public television station **KNPB, Channel 5** in **Reno, Nevada.** This year, **KNPB** is spending about $9,500 in postage to send 74,000 program guides, 33,000 fundraising letters, 70,000 direct mail solicitations, and 3,000 educational pieces to its Nevada viewers. If the non-profit rates double, in order to send out the same level of mail **KNPB** would be forced to cut out one newly full-time position in its membership office. Or, to use programming as an example, **KNPB** currently spends $8,900 for a year of its most widely viewed PBS program, Nature. Amounting to nearly 10% of its program costs from PBS for a year's worth of national programming, $9,000 could also pay for a year's worth of both Great Performances and Wall Street Week for **KNPB.**

In **Tucson, Arizona, station KUAT** this year will spend $25,100 for mail, including $2,800 to send program guides to 50,000 members, $11,600 to mail fundraising pieces, $6,500 to solicit new members, and $4,200 to mail educational tapes and materials. Like many of our stations, **KUAT** has discovered that the frequency of contact with new

member prospects influences the response; recently, they realized $52,000 from a 14,000 piece mailing. Any increase in postage for them would result in fewer mailings, and thus, fewer contributions. KUAT has also stated that they would cut in half the educational material they send if their rates double.

Stories like South Dakota's, Nevada's, and Arizona's can be found in every state in the Union--just as our stations are beginning to bring in record levels of support from their audiences to compensate for other losses in revenue, they are having to face cuts from other sources that have a direct impact on the funds they can raise. The total system's figures are devastating enough, but taken on a station-by-station basis, what may seem like a small amount of money represents programs, personnel and the overall excellence that each station wishes to continue.

We would ask the Subcommittee to do all in its power to recognize the widespread ill effects that the elimination of the non-profit mail subsidy would have on public television stations and their audiences. We urge the Subcommittee to appropriate funds sufficient to maintain these postage rates at current levels.

ATTACHMENT

Nationwide Effects of the Elimination of the Postal Subsidy
on Public Television Stations

ITEM	NUMBER OF PIECES	CURRENT RATE FY85/ PROPOSED RATE FY86	TOTAL $ FY85
Program Guides at 2nd Class, Non-Profit	2 million subscribers x 12 issues/year = 24 million mailings	$.066/ $.125	$1,584,000
Program Guides at 3rd Class, Non-Profit	1.8 million subscribers x 12 issues/year = 22 million mailings	1/2 @ $.034/$.101 1/2 @ $.049/	$ 913,000
Fund Raising Letters & Follow-ups at Bulk, Non-Profit	43 million mailings	1/2 @ $.034/ 1/2 @ $.049/$.101	$1,785,000
Teacher Guides, Tapes and other materials at 4th Class rates	4 million pieces		$ 500,000
TOTAL	89 million pieces		$4,782,000

Source: PBS

CONCLUSION:

At the proposed zero subsidy, the effective average rate increase would equal 100%. For public television stations, this means an increase nationwide of $4,282,000, for a total of $8,564,000 for FY1986 mail at current volume.

National Federation of the Blind

STATEMENT OF JAMES GASHEL, DIRECTOR, GOVERNMENTAL AFFAIRS

Senator Abdnor. Our next witness is James Gashel.

Mr. Gashel. My name is James Gashel and I am director of governmental affairs for the National Federation of the Blind.

I will move quickly to my statement dealing with the Postal Service and try to expedite that as much as possible.

You have heard, and you are well aware of the fact that we are really in a very precarious situation as far as the postage rate issue goes, especially this year. I think Mr. Shorey did a real good job of tracing through the various results that could occur if the administration's proposal for the zeroing out the revenue forgone is, in fact, carried out by Congress.

You know, the thing I want to emphasize is that the provisions of the Postal Reorganization Act which allow for the mailing free of books for the blind, for example, and various equipment related to recording or playing those books as well as the reduced rate subsidies for nonprofit

organizations actually carry out very longstanding policy of this country which existed prior to the Postal Reorganization Act. Free mailing of the books for the blind goes back to 1904. So in enacting the Postal Reorganization Act what Congress was trying to do was set up a system to carry out the policy we have had for a long time in this country and to do so without placing major burdens on nonprofits and the groups that benefit from this particular program and not putting them out of business in the process of reorganizing the Postal Service.

Now that system has worked very well for the tenure of the Postal Reorganization Act. If it is time to rethink the idea of providing Federal funds to pick up the revenue forgone by the Postal Service, and we are not sure it is time to do that, but if it is time to do that, what we are afraid of is it is not being done in the orderly process of looking at the authorizing legislation by the committees that are responsible for doing that. It should certainly not be done in the heat of a budget crisis and the need to balance the budget because of the uniquenesses of the Postal Reorganization Act.

The plain fact of it is that under the current law Congress doesn't set postal rates anymore, so any zeroing out of the current funding in this area will mean that for at least the short term, even if a cross subsidy plan later comes into effect, for at least the short term the rates will have to go commercial unless some major legislative gyrations happen and Congress decides to set the postage rates, which is a fairly unlikely event. Beyond that, in the long term there is a very serious question as to whether it is a desirable public policy to pit the interests of commercial postage ratepayers against the interests of nonprofit organizations.

Inevitably, what we are going to see is we will eat up massive amounts of charities doing battle before the Postal Rate Commission as to what rates should be. Inevitably, the commercial ratepayers will want the rates to be as low as possible and we will want the rate to be high enough so that our rates do not become commercial. So that we have a continuous battle looming in the future if the appropriations method for handling revenue forgone is not pursued. These are some of our concerns.

I would just like to simply say, in echo to the statements made by public television, this is a time when the nonprofit sector is expected to pick up a lot of the slack that Government programs are going to be dropping and have been dropping. This is just fine, but we have to have the ability to continue to reach those sources of funding and we have to have the ability to keep up some types of programs, and mass communications with the general public, in our case, is just absolutely certain for us. So that is our real concern, that at a time when—this is a time of constriction of Federal funds, our ability to reach out and tap the resources of the private sector should also not be eliminated. Otherwise, the first objective of eliminating Federal support cannot be achieved because inevitably people will have to come back to the Government to seek the assistance they cannot get from the private sector. That is what worries us most in the National Federation of the Blind.

We hope it worries you too so that the appropriations for revenue forgone can be continued.

Thank you very much.

Senator ABDNOR. Thank you. You have a report from the blind and other severely handicapped.

Would you like to comment on that?

Mr. GASHEL. I would, if it is in order.

Our grave concern is that the Committee for Purchase for the Blind and Other Severely Handicapped is not directing enough of its efforts at resources to expand employment services for handicapped, particularly, in supervisory and management jobs. Under the authorizing legislation, the committee uses two central nonprofit agencies, which are called National Industries for the Blind, and National Industries for the Severely Handicapped to perform many administrative functions. All those agencies do not employ blind people in responsible managerial positions and many of the sheltered workshops do not.

These and other deficiencies in the committee's program were noted in a House report issued during the 98th Congress by the Government Operations Committee, but there is very little evidence that anything meaningful in the way of corrective steps have been taken. As a result, what we are doing here is recommending that future appropriations requests be accompanied by specific data comparing the jobs, pay and fringe benefits provided to blind and handicapped people in the program with contrasting data showing the jobs, pay, and fringe benefits provided to sighted people who are not handicapped in the program. This information should also be submitted to your subcommittee by National Industries for the Blind and National Industries for the Severely Handicapped who work directly under the committee's jurisdiction.

The House report also expressed concern that funding of the noncentral nonprofit agencies through the Committee on Government Purchases is not a system that is rationally related to the funding needs of these agencies. So we are recommending to the subcommittee that future appropriations requests by the committee include cost data in order that you can actually understand what expenditures are actually made in administering this particular program. Disclosure of this information will also help to assure that funding of the central nonprofit agencies is used strictly for the authorized purposes of the law.

PREPARED STATEMENT

Those are my comments concerning that issue.

Thank you.

[The statement follows:]

STATEMENT OF JAMES GASHEL

Mr. Chairman, my name is James Gashel. I am Director of Governmental Affairs for the National Federation of the Blind. My address is 1800 Johnson Street, Baltimore, Maryland 21230. Thank you for the opportunity to testify before the Subcommittee today on concerns we have relating to agencies whose appropriations fall within your jurisdiction.

I represent the National Federation of the Blind. We are a nationwide membership organization of blind persons. More than 50,000 blind people belong to the Federation. They join through local chapters which exist in most sizable population areas and through state affiliates of the Federation organized in each state and the District of Columbia. The National Federation of the Blind is first and foremost a grassroots people's organization. As such, we directly represent and speak on behalf of the blind consumer. Our positions on public issues, such as those before the Subcomittee today, are reached through policies and resolutions adopted by vote of the blind, themselves. This is what the National Federation of the Blind is all about--"the blind speaking for themselves."

Mr. Chairman, our most vital and immediate concern is that adequate appropriations must be approved to continue special mail rates which bring services and help to many thousands of blind citizens. My statement will deal primarily with these matters and the consequences of accepting the President's plan to end the revenue foregone postal subsidy. In addition, I will discuss how appropriations for the Committee for Purchase from the Blind and Other Severely Handicapped should be used to achieve greater employment opportunities for the individuals intended to be served.

THE REVENUE FOREGONE APPROPRIATION

You are well aware that the Postal Reorganization Act of 1970 continued the practice of providing certain free and reduced rate mailing services. This is done through an appropriation under this Subcommittee's jurisdiction. The appropriation is for revenue foregone by the United States Postal Service to fulfill the free and reduced rate requirements. The amount appropriated for Fiscal Year 1985 is $801 million. The postal service has advised that full funding of revenue foregone would require nearly $981 million for Fiscal Year 1986 and a supplemental appropriation of $168,620,000 for Fiscal Year 1985.

The President's budget proposes an end to the appropriation but promises to continue the subsidized mailings that include free matter for the blind and reduced rate postage for bulk mailings made by certain nonprofit groups. The subsidy would have to be financed by the postal

service through increases in other postage rates. But increasing postage rates is a complex matter, requiring proceedings before the postal rate commission, generally lasting about eighteen months. Meanwhile, there would be a continuing need for the revenue foregone appropriation.

If the budget proposal is accepted, the interests of large commercial mailers would be forever pitted against nonprofit groups causing valuable resources to be wasted in future battles over postal rates. This would only be one of many disastrous consequences for our programs. Consequently, we strongly support continuing the appropriation for the revenue foregone postal subsidy. Here are the facts and needs you should consider.

Free Matter for the Blind and Handicapped

Under existing law (39 U.S.C. 3403 and 3404), blind people receive certain books, materials, equipment, and information free of any charge for postage. This service is paid for from the funds appropriated for the postal service's revenue foregone subsidy. During Fiscal Year 1986, it is estimated that the free mailing services for the blind and physically handicapped authorized by these sections of the Postal Reorganization Act will cost $37,882,000. This compares to the actual expense of $33,946,000 during Fiscal Year 1985, according to the United States Postal Service. As the numbers indicate, federal support for free mailing authorized by these sections of the Act is a relatively small part of the many beneficial services made possible by the revenue foregone appropriation.

Although by comparison to other services, the cost of free mailing for the blind and physically handicapped is minor, it would be impossible to place a price tag on the actual human and social value derived from this necessary service. Think of what it would be like if, tomorrow let us say, all of the newsstands or bookstores you frequent and depend upon were closed. Then imagine your frustration if the library which serves you had no books you could use. What if all of your reading material (books, magazines, articles, what have you) had to be sent to you via the U.S. mails? What if there was no newsstand, bookstore, or library within 200 miles of your home? Imagine that.

This is what blind people are used to. If I want a dictionary (even a small one) or a copy of the Bible (still the world's most popular book), I cannot simply walk to the nearest commercial bookstore or library to get one. Neither the dictionary nor the Bible will be available in a media I can read. For most blind people (even those who live in large cities) the only source for these common books is a lending library located miles and

miles away. This means that the books must be shipped through the mail in returnable, reusable containers. Each carton may weigh five to ten pounds or more and hold only a few volumes of the book in question. Even a small pocket-sized dictionary will require six or more large volumes of Braille.

Surely it is obvious from this abbreviated explanation that the free mail service made possible by the revenue foregone appropriation is a matter of necessity. It is not a privilege nor a luxury. There is simply no practical alternative. If Congress agrees to terminate funds which now pay the small costs of mailing free various library materials, specialized equipment, and information for the blind and physically handicapped, the services themselves will end. The books and magazines will grow dusty on the shelves. Then, tens of thousands of our citizens will become isolated immediately from information and educational materials they depend upon daily. Gradually the blind will lose hope and their dreams of opportunity will be gone. Clearly, the use of the mails for sending books, equipment, and other information and aids free to the blind and physically handicapped provides a vital link that means the difference between participation or isolation of the blind and physically handicapped.

Reduced-Rate Mail

Mr. Chairman, while the free mailing issues just discussed are of obvious and vital importance to the nation's blind consumers, those concerns must not overshadow the grave crisis now brewing over costs to be charged to groups that mail at reduced or preferred rates.

The plan to eliminate the revenue foregone appropriation entirely would also bring an end to much needed help and hope for the nation's blind. For instance, an organization the size of the National Federation of the Blind uses a very small portion of the revenue foregone subsidy. This is pennies to the federal budget. Yet, to our budget (the budget of the National Federation of the Blind) we cannot afford to sustain a doubling of our postage rates. It is a false and misleading distortion to claim that taxpayer savings will actually result from ending the postal subsidy. What about the costs to the U.S. Treasury that will surely increase because private sector programs such as ours cannot operate? In the space of only a few years, the National Federation of the Blind has helped to stimulate jobs and opportunities for thousands of our fellow blind who would otherwise live at public expense. I doubt that anyone (least of all the budget planners) would question that such privately sponsored assistance has tremendous value.

Six cents per piece is the current third-class nonprofit bulk mailing rate which we use. This is up from 5.2 cents per piece paid prior to February 17, 1985. If appropriations are eliminated for the revenue foregone payment, the third-class nonprofit postage rate would more than double later this year. 12.5 cents per piece is the commercial third-class rate. This would be the amount charged to nonprofit organizations without adequate appropriations to meet the difference. At the 12.5 cent third-class per piece rate, an organization mailing 1,000,000 pieces would pay $125,000, as opposed to $60,000 for a similar mailing presently.

A postage rate escalation of this magnitude would mean the difference between survival and destruction of private efforts to aid the blind. The additional amount paid in postage would be taken directly from program services which now help the blind. It would also be impossible to contact new potential contributors to raise additional revenues. If communications with blind persons and the public at large are cut, a time bomb is created, since fewer people will understand anything about blindness and even fewer will know of the continuing need to help. The inevitable result is a downward spiral, with fewer people helped and fewer people helping. Soon the self-help organizations of the blind will be destroyed. These are the unanticipated ripple effects of rising postal rates, but they are nonetheless very real. The ability to communicate at an affordable cost is vital. Without it, many worthy efforts on behalf of the nation's blind will diminish or die altogether. Since fifty thousand Americans become blind each year, there must either be continued widespread mailings to the general public to inform them about blindness and how to deal with it or else an increasing number of the newly blinded will not be found until it is too late and they are hopelessly doomed to continuing dependence.

Here is a letter we recently received from one individual who recently responded to our mailings. Remember, there are thousands who face similar circumstances:

Friday, April 4, 1984

To Whom It May Concern:

This letter has taken me two weeks to write. I am losing my eyesight to macular degeneration. In writing this letter, I am admitting I have a problem--a problem I never thought I would have to face.

One eye is gone. I thought I could make it, but the other eye is leaving me also. As this happened spontaneously (over

night) with my left eye, I do not know for how long I may keep what sight I have in my right eye.

I don't have anything brilliant to say or any wonderful remarks about how brave I am. I am very frightened and just plain sick in my guts as to what I am going to do. I am 47 and live alone. I live on Social Security and have many other health problems.

Would appreciate hearing from you. I need all the encouragement and help I can get. Many thanks.

Margo Bedrosian
P.O. Box 605
Yucca Valley, California 92284

What will happen to Margo Bedrosian and thousands of others if we have no way to know of their need or to reach out to them to offer help? Now we can do so via the mails at a price we can still afford. But what about the future? That is what worries us most. Mr. Chairman, it is absolutely essential therefore, that we continue the public policy of supporting the beneficial services of nonprofit groups which deliver private sector sponsored help. Toward this end, full funding of the revenue foregone appropriation will be necessary. This is our request.

EMPLOYMENT OPPORTUNITIES THROUGH THE COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

I now turn to the program of the Committee for Purchase from the Blind and Other Severely Handicapped (CPBOSH). This program is intended to stimulate greater employment opportunities by using sheltered workshops for the production of items and services bought by the federal government. The Fiscal Year 1986 appropriations request is $730,000.

CPBOSH is the federal government's administrative arm for procurements from workshops employing the blind and severely handicapped. A report of the House of Representatives Committee on Government Operations (House Report 98-546, issued November 15, 1983) has found the administration of this program by CPBOSH wanting in several respects. Recommendations are made directing CPBOSH to correct the deficiencies noted in the report.

As a representative organization of blind people, many of whom work in the sheltered workshops producing goods for federal use, we especially hope that CPBOSH will move aggressively to improve employment opportunities for the blind in ways recommended by the House Report. But there is no evidence that anything tangible is being done.

While it may often be the case that 70% to 80% of the direct labor workforce of each shop is composed of blind or handicapped people, most

management and supervisory positions are occupied by sighted people without handicaps. Keeping the blind in labor jobs results in a great pay disparity. For example, in one workshop we examined, 61% of the workforce was blind, but that group received only 43% of the pay and fringe benefits of the plant. Meanwhile, the 39% who were sighted received 57% of the pay and benefits. Statistics like these could be shown for virtually every workshop under the CPBOSH program. This data shows that blind and severely handicapped people are not the primary beneficiaries of the program, despite the intent of the law.

As required by the House Report, CPBOSH is expected to initiate efforts to expand jobs for the blind and severely handicapped. Clearly some of the resources you appropriate should be devoted to this activity. Congress should hold CPBOSH accountable to insure that the goals of better employment for the blind and severely handicapped are achieved. Toward this end, we are asking that the report accompanying this year's appropriations bill include requirements such as those in the attachment to this statement. This will greatly assist members of Congress, blind consumers, and the general public in our efforts to assure that CPBOSH actually provides an employment service to the blind and severely handicapped and that the service is fair to those intended to be helped.

CONCLUSION

Mr. Chairman, again, I thank you for giving me the opportunity for this appearance before your Subcommittee. We appreciate your past very sensitive efforts and those of your colleagues. This is a great time of need for us, especially with the budget crisis and the postal rate problem. We ask for your continued support in these areas and thank you for the careful consideration we know you will give our requests. I thank you.

REPORTS FROM THE COMMITTEE FOR PURCHASE FROM THE BLIND AND OTHER SEVERELY HANDICAPPED

The following report language is recommended relative to future reports the Subcommittee should require from the Committee for Purchase from the Blind and Other Severely Handicapped: "The Committee is concerned over reports that the CPBOSH (Committee for Purchase from the Blind and Other Severely Handicapped) may be failing to provide adequately for expanding employment opportunities for blind and severely handicapped individuals. Particularly, there is evidence that blind and severely handicapped people are not recruited or promoted into management or

supervisory positions in the sheltered workshops or in the central nonprofit agencies. These agencies (National Industries for the Blind and National Industries for the Severely Handicapped) are designated by CPBOSH to operate on its behalf in administering this program and function directly under CPBOSH jurisdiction. Yet, there is evidence that the employment practices of the central nonprofit agencies (especially with respect to recruitment and promotion of blind and severely handicapped individuals) have not been closely monitored by CPBOSH. Also the Committee needs more complete financial information to assess the operations of these instrumentalities which participate substantially in the administration of the CPBOSH program.

The Committee believes that the sheltered workshops and the central nonprofit agencies should become model employers for the utilization of blind and other severely handicapped individuals in all positions and at all levels of responsibility. To aid CPBOSH in achieving these goals, justifications submitted to the Committee, beginning with the 1987 appropriations request shall include specific data in sufficient detail to make possible a comparison of employment opportunities, pay, and benefits which the CPBOSH program provides to (1) blind individuals, (2) other severely handicapped individuals, and (3) other individuals who are neither blind nor severely handicapped. Specific data shall also be included to show the positions, pay, and benefits provided to blind individuals employed by National Industries for the Blind as compared to the positions, pay and benefits provided to sighted individuals employed by that agency. Similar information shall likewise be submitted with regard to employment opportunities provided by National Industries for the Severely Handicapped.

The Committee is also advised that a substantial portion of the revenues expended to administer the CPBOSH program are derived from commissions paid to the central nonprofit agencies from purchases made by the government. The commission revenues finance the central nonprofit agencies and provide over 90% of the funding for this program. These payments derived from federal purchases are above and beyond the amount appropriated directly for salaries and expenses of the CPBOSH. Beginning with the Fiscal Year 1987 appropriations request, CPBOSH is directed to submit cost information showing how the commission rate paid to each central nonprofit agency is justified. Such information shall also include the audited financial statement of each central nonprofit agency for the fiscal year just ended, a financial operating statement up to date for the fiscal year in progress, and a budget for the fiscal year in progress at the time the justifications are submitted."

AMERICAN COUNCIL OF THE BLIND

STATEMENT OF J. SCOTT MARSHALL, DIRECTOR, GOVERNMENTAL AFFAIRS

Senator ABDNOR. Thank you.

Our last member of the panel is J. Scott Marshall.

Mr. MARSHALL. Thank you.

I am director of governmental affairs for the American Council of the Blind.

We also support an appropriation in the amount of $981 million for the revenue forgone for postal service as requested by the Postal Service. We believe that the administration's proposal to subsidize the cost of free- and reduced-rate mail from full ratepayers is unfair to them and is fraught with uncertainty and we submit to you that if something needs fixing, it should be fixed. If not, it shouldn't be fixed. If there are problems with revenue forgone subsidy and some of its uses, that can be handled by looking specifically at the authorizing legislation for this program, and we should not allow ourselves in the pressure to balance the budget to throw out a very important program that benefits many, many, many Americans.

We are concerned about revenue forgone in two aspects: First, the free matter for the blind and physically handicapped mailing privilege. I think if you ask any Member of Congress whether they support mailing of braille, recorded materials, equipment to and from blind persons, they would say, of course, we do. It is a small program. It costs only $37.882 million. Our concern, though, is that this small program will fall through the cracks in this time of budget crisis, and we want to make sure that the record is clear as to the value of the program to the people that it serves.

This issue of National Geographics that I am holding in print is not available to a blind person on the local newsstand or a bookstore. He or she has to obtain the magazine through a program cooperating through the Library of Congress. Here is the braille edition. You see it in two volumes. The third-class rate would cost $2.38. The blind almost entirely depend on the use of the mail for delivery of books and materials.

Individuals also use the mail to communicate. A sheet of paper, two sheets of 8½ by 11 would go in a No. 10 envelope. You can see that the bulk of braille would make any kind of a long letter prohibitively expensive for the individual to bear.

We are also concerned about the revenue forgone postal subsidy with respect to the effect on nonprofit organizations. Here again, although the American Council of the Blind is not a big user of the nonprofit mail rates, we do mail our magazine to our members, our monthly magazine, using the free matter privilege, and if this subsidy were not continued, this would represent a great drain on our resources. As every other nonprofit organization knows, we are also looking to save a buck and try to go get as much mileage out of that buck as we can.

My colleague from the Legion is right, all of our organizations should think very carefully about how we spend our money and demonstrating the fact to the public that supports us as to our public service capability.

I submit to you, Mr. Chairman, that if we were required to pay full postage on our materials, this would be a great diversion of our funds from services to people, services that are not provided by Government agencies currently. I am talking about answering people's telephone calls, relative to Social Security problems, discrimination complaints, providing information to the public regarding blindness and visual impairment, regarding services that are available, and basically even those things which you might think are insignificant. The how do you do this and so on as a blind person. We get numerous calls from newly blinded people who need this kind of information. We have to hire people to provide that information. We have to send the materials in the mail. Again, any increase in postage would require most certainly to curtail some of these activities.

PREPARED STATEMENT

For these reasons we hope you will recommend as the House committee has recommended to the House Budget Committee that a full appropriation of $981 million be included for the revenue forgone subsidy for fiscal year 1986.

Thank you.

[The statement follows:]

Statement of J. Scott Marshall

Mr. Chairman: The American Council of the Blind is this nation's leading membership organization of blind and visually impaired people. For over 20 years we have strived to improve the lives of this nation's blind and visually impaired citizens through legislation, legal advocacy, and public education. We appreciate the opportunity to testify before you today concerning a vitally important federal program to blind and visually impaired Americans; namely, the "free matter for the blind and physically handicapped" mailing privilege, funded by the revenue foregone postal subsidy.

Legislation first enacted in 1899 permitted blind persons to mail unsealed letters in raised characters at third class postage rate. Subsequent changes to the statute, totalling some 14 amendments through 1970, made significant improvements in the program by permitting materials such as braille typewriters, cassette players, braille/recorded/large print books, and other products specifically adapted for blind persons to be mailed, by increasing the number of persons who could use the privilege, and by reducing mailing costs.

For the reasons set forth below, we urge your subcommittee and the full committee to recommend to the Senate an appropriation equal to the amount requested by the Postal Service for the revenue foregone postal subsidy for FY1986. Zero funding of the "free matter" mailing privilege, as proposed in the President's FY1986 budget, would annihilate one of the most important and valuable federal benefits to blind and visually impaired Americans. We do understand, Mr. Chairman, that the Senate-Administration deficit reduction plan which will probably be on the Senate floor this week does assume budget authority sufficient to appropriate $37.882 million for the "free matter for the blind and physically handicapped" mailing privilege.

Why should blind persons, libraries, and other organizations which serve blind persons pay postage on these materials? Braille and recorded books, braille paper, and specifically adapted equipment (such as slow speed phonograph and cassette players) are heavy, bulky, expensive, and generally commercially unavailable. As a blind person, I cannot go to my local newsstand to purchase a braille or recorded copy of Newsweek, US News and World Report, National Geographic, American Heritage, or National Review. Similarly, most local public libraries cannot provide me with a braille or recorded copy of Gone With the Wind, poetry by Robert Frost, or current bestsellers.

In recognition of the need to facilitate literacy among blind people, Congress established in 1931 a special division of the Library of Congress to provide library service to blind adults through a network of regional distribution centers. In that year, with a start-up appropriation of $100,000, the Library of Congress produced 15 titles which were loaned to blind readers through 19 cooperating regional libraries.

The Library of Congress soon began distribution of recorded "talking books" and began to loan to blind persons the specially designed "talking book" machines on which the discs could be played.

In 1983 by contrast, the latest year for which published data is available, the National Library Service for the Blind and Physically Handicapped (NLS) reported circulation of 18,200,000 pieces consisting of approximately 11 million discs, 6.6 million cassettes, and over 600,000 braille volumes. Readership in 1983 was 526,000, with 41,000 titles maintained in the library's national collection. These materials, as well as specially designed play-back equipment and accessories, are loaned by the Library of Congress for distribution through a network of approximately 160 regional and subregional libraries throughout the United States and its territories. Library service is also provided to American citizens residing overseas.
The cooperating regional and subregional libraries derive their operating expenses primarily from state and local funds with some federal support through the Library Services and Construction Act. The combined expenditure in 1983 from all sources for library service to blind and physically handicapped persons was approximately $60 million. Table 1 provides budget, circulation, and readership data for selected states and territories.

These figures are indeed impressive but we must keep in mind that the amount of information available to blind and physically handicapped persons in braille, recorded, and large type media is only a small fraction of the amount of printed information available to the sighted public. Even so, the fine library service which blind and physically handicapped people now enjoy could not exist without the "free matter" mailing privilege, since this special library service is conducted almost exclusively through the mail.

In fact, free mailing of books by libraries authorized by the 1904 amendments to the statute contributed to the need for a national production and distribution system which Congress authorized in 1931. The inability to mail reading materials free of charge would greatly inhibit access by blind persons to information vital to a literate society. Consider the words of Mr. Robert B. Irwin, Executive Director of the American Foundation for the Blind, speaking before the 1929 annual meeting of the American Library Association concerning the need for a national library system for blind persons and the effect of the free mailing privilege on library usage by blind individuals:

> A few progressive libraries placed attendants in charge of [braille] collections. These attendants encouraged the mail order business and gradually built up a large clientele spread...over several states. Today we have about 15 libraries... with one or more attendants giving full time to this work. Libraries having no regular attendants to promote this activity were unable to handle satisfactorily the mail requests and in time practically discontinued all library work for the blind. Today more than 90% of the books lent by libraries for the

> blind are called for by mail or telephone and practically all are sent out through the post office.[1]

Mr. Chairman, most blind people because of distance could not travel to a regional library to pick up their books, and accordingly Mr. Irwin's words about the dependence of blind persons upon the mail for their library service were as true in 1929 as they are today.

But let me take a quantum leap back to the present. How much postage would have to be paid by blind persons, libraries and other organizations if the "free matter" mailing privilege were not available? This braille copy of National Geographic magazine is produced under the auspices of the National Library Service for the Blind and Physically Handicapped and is sent free to blind persons who request it. The braille version does not, in accordance with postal requirements, contain advertising, and unfortunately the Geographic's fine photography cannot be reproduced in braille. This braille edition weighs approximately 6 ounces and is presently sent through the mail via "free matter for the blind and physically handicapped" without postage. Postage for this magazine would be $1.82 for two zones at the third class rate.

Allow me to give you some other examples. Gone With the Wind, which I spoke of earlier, would cost over $20 in postage round trip to and from the regional library. Mailing of the 24 volumes which comprise Webster's New World Dictionary in large type would cost $40 in postage. Table 2 shows the average weight of braille and recorded books, playback equipment, and accessories together with estimated postage costs at third and fourth class rates. The effect of postage costs on library budgets would obviously be devastating.

And let us not overlook the economics of mailing braille and recorded material by individuals. Braille paper and cassette tapes are heavy when used by blind persons for correspondence. Only about two braille sheets (approximately 1,450 characters) could be sent in a No. 10 envelope for a 22¢ first class stamp. A cassette in its mailer weighs three ounces and would cost 56¢ for mailing. Many blind persons could not afford these rates, let alone the cost of returning materials to the library.

This is because most blind and other disabled people are poor. In 1981, the National Library Service for the Blind and Physically Handicapped surveyed its readers and found that 37% had incomes of $5,000 or less, compared to 9% of the general population with incomes of $5,000 or less. Minority users of the National Library Service were even more impoverished with 60% having incomes less than $5,000.[2]

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[1] So that all may read: Library Service for Blind and Physically Handicapped People, National Library Service for the Blind and Physically Handicapped, Library of Congress, 1983, pp. 6-7.

[2] "Readership Characteristics and Attitudes," a study prepared for the National Library Service by Market Facts, Inc., Table 7, September 1981, pp. 3.5 and 4.41.

In addition, the U.S. Census Bureau recently reported that 26% of disabled working age adults have incomes below the poverty line. This poverty rate is two and one-half times higher than that for nondisabled working people.[3]

The Social Security benefit statistics bulletin for January 1984 reports that 79,534 legally blind people receive SSI benefits which are based on economic need. Of this number approximately 23,000 persons are age 65 or older. In addition, the Office of Research and Statistics of the Social Security Administration estimates that 93,000 blind persons whose adjusted income is less than $610 per month receive Social Security Disability Insurance benefits.

The National Society to Prevent Blindness estimates that there are approximately 498,000 legally blind Americans who by definition would be eligible to use the "free matter" mailing privilege. The Society further estimates that approximately 45,000 Americans become legally blind each year and that 75% of legally blind Americans are 40 years of age and older. Blindness is also a barrier to employment which gives rise to an unemployment rate of from 50 to 70 percent.

Thus it is apparent that payment of regular postage rates on braille, recorded and other material would be prohibitively expensive and beyond the reach of most blind persons.

Finally, Mr. Chairman, I have used the word "privilege" today referring to the "free matter for the blind and physically handicapped" mailing program. This is because the members of the American Council of the Blind value this program and jealously guard it from abuse. I am happy to report that to our knowledge there have been very few instances of abuse of this important privilege. The Council has consulted with other organizations serving blind persons concerning the use of the "free matter" privilege, and has in fact reported violations to postal officials when, for example, an organization serving blind persons attempted to mail its newsletter in standard type free of postage as opposed to the 14-point sight saving type required by the law. We hope that Congress will continue to appropriate funds for the "free matter" subsidy. Although we understand that the Office of Management and Budget will propose legislation which may include "free matter for the blind and physically handicapped" in its list of free and reduced rate mailers for whom a cross subsidy between full rate payers would be available, we agree with the Postal Service that the present mechanism by which Congress appropriates funds earmarked for free and reduced rate mail should not be supplanted by an untested cross subsidization scheme between full rate classes and free or reduced rate mailers.

It seems to us, Mr. Chairman, that we have had to come to Congress several times since 1981 to protect the "free matter" program. Each time we have prevailed, but

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[3]U.S. Census Bureau Labor Force Statistics and Other Characteristics of Persons With Work Disabilities, Series P-23127 , 1982; See also "Physical Disability and Public Policy," Scientific American, Vol. 248, No. 6, June 1983, p. 42.

each time at a cost. I am speaking of not only the human cost of uncertainty and fear of losing this privilege among people who rely upon it so heavily, but also the diversion costs: the time, energy, and resources which could be applied to advocating for blind and other disabled people rather than reacting to what has almost become a perennial exercise. The question, Mr. Chairman, I guess is why? The American Council of the Blind deeply appreciates the past bipartisan support in Congress for the "free matter for the blind and physically handicapped" mailing privilege. I will be happy to answer any questions at this time.

Table 1

Library Services for the Blind and Physically Handicapped
Selected States Showing Readership, Circulation,
Budget and Size of Circulation for FY1983*

		Circulation			Size of
	Readership	Braille	Recorded	Budget	Collection
California	36,990	67,800[1]	1,429,100	$1,691,612	692,700
Missouri	11,100	21,600	471,400	280,430	146,400
New York	46,170	57,200	1,156,700	1,176,157	1,119,900
Texas	26,680	31,700	869,100	852,928	385,800
Utah[2]	6,260	590[3]	5,670	381,350	260,600
Virgin Islands	310	200	8,100	63,105	25,100

[1] includes distribution to Arizona

[2] also serves Wyoming

[3] also serves braille readers in Alaska, Colorado, Idaho, Montana, Nebraska, Nevada, New Mexico, North Dakota and South Dakota

*Excerpted from Library Resources for the Blind and Physically Handicapped: a Directory of FY1983 Statistics on Readership, Circulation, Budget, Staff and Collections, National Library Service for the Blind and Physically Handicapped, Library of Congress, 1984.

February 21, 1985

Table 2

Average Weight of Equipment, Books and Catalogs		Mailing Class*	Average Cost to Mail One Way (2 Zones)**
Cassette Machine	6.45 lbs.	4th	$1.82
Phonograph	12.84 lbs.	4th	$2.26
Headphones	1.35 lbs.	4th	$1.41
Cassette Book (2 cassettes, 1,4-cassette mailer)	.47 lbs.	3rd	$ .88
Flexible Disc (8 disc, 1 mailer)	.39 lbs.	3rd	$ .88
Recorded Disc (3 disc, 1 mailer)	2.10 lbs.	4th	$1.49
Braille Book (3 vols, 2 mailers)	13.04 lbs.	4th	$2.32
Magazines (flexible disc)	.12 lbs.	3rd	$ .22
Talking Book Topics (Print)	.5 lbs.	3rd	$ .98
Catalog(s) (print)	2.0 lbs.	4th	$1.41

*Source:
Postal Bulletin
PB 21493
Revised February 1, 1985
Special Bulletin
New Rates and Fees as of 2/17/85

**Average costs only. Local costs may very per number of zones or weight interpretation.

PREPARED STATEMENT OF THE AMERICAN HEART ASSOCIATION

Senator ABDNOR. Thank you.

That concludes our panel. I see we have about 5 minutes to 3. We do not like to curtail anyone but I don't think I will go into questions. I do want to say that the American Heart Association has submitted a statement for the record and I ask unanimous consent that it be included at this point.

[The statement follows:]

STATEMENT OF THE AMERICAN HEART ASSOCIATION

Mr. Chairman, AHA is pleased to have this opportunity to provide you with our recommendations regarding FY 1986 funding of the revenue forgone postal subsidy.

The American Heart Association is comprised of 55 affiliate organizations and over 12,000 local components directed, aided and assisted by 120,000 community volunteers, 12,500 medical and scientific volunteers and over 2 million fundraising volunteers. AHA is the only voluntary health agency in the United States that devotes all of its resources to one goal: the reduction of premature death and disability due to cardiovascular disease.

In seeking to fulfill our mission, we have committed ourselves to excellence in each of our program areas: research, professional and public education and community programs. AHA devotes over 30% of its resources to the continual search for knowledge in the causes, prevention and treatment of heart disease, stroke and related disorders. AHA efforts in the area of professional and public education are based on sound medical knowledge and principles. We provide continuing education for physicians, nurses and other health professionals as well as educate the public with regard to the major risk factors for cardiovascular disease -- smoking, hypertension and high cholesterol levels. And finally, our community programs include program packages designed to educate various targeted audiences, such as elementary school children or individuals in the work place, regarding heart disease risk factors. We appear before you today to express our opposition to the Administration's budget proposals regarding the revenue forgone postal subsidy and to inform you of the devastating consequences of the implementation of these proposals.

As a 501(c)(3) designated organization, we are able to mail at lower, third-class nonprofit rates. This preferred rate enables AHA and its affiliates to devote more of our resources to the above-mentioned program areas. We strongly believe that at a time when Federal financial support of these types of programs is declining, and public demand is increasing, it becomes imperative that organizations such as ours be in a position to support their programs at sufficient levels to meet this increased public demand.

As part of its FY 1986 budget, the Administration has proposed total elimination of the revenue forgone postal subsidy and the adoption of

legislation that would require the Postal Service to absorb the future costs of third-class nonprofit mail. Implementation of such a proposal would mean that other classes of mailers would "cross-subsidize" third-class nonprofit mailers, a practice which is contrary to current law. Under this proposal third-class non-profit rates would jump to step 16 levels. Depending on the level of presort, our rates would increase anywhere from 23.3 to 41.2 percent. We would like to provide you with some specific examples of the detrimental impact such an increase will have on AHA programs throughout the country.

In carrying out our programs, AHA relies quite heavily on the use of preferred rate mail. AHA is continually in search of funds to support its research and educational activities and one source is from our direct mail fundraising campaign. In 1984 $8.3 million, or 5.3 percent, of our revenue was derived from direct mail income. Postage accounts for approximately 28 percent of our direct mail fundraising expenses. However, more importantly, we rely on subsidized mail for the dissemination of general educational materials, CPR course materials, scientific publications and newsletters to our members throughout the country. Our National Center's postage bill for 1984 was approximately $523,000 for all of its program activities -- approximately 93% of these costs are for third-class mailings. As is evident, a substantial increase in our postage expenses, such as the one proposed by the Administration, not only has a negative impact on our ability to raise funds, but doubly curtails our ability to provide services: increased postage costs mean less available program dollars as well as higher operating costs.

Many of our Affiliates have expressed that an increase to step 16 levels would have a negative impact on all of their program areas as well. In order to absorb increased postage costs, our California Affiliate predicts that it would have to reduce its direct mail campaign by approximately ten percent. This reduction in mailings transfers into an income loss of about $100,000 in one year alone. Loss of this income would mean that the California Affiliate could fund 6 fewer cardiovascular research fellowships next year.

Our Texas Affiliate estimates that they would suffer a loss in income of about $160,000 as a result of the proposed rate increase. About $70,000 of this lost income would come from the research category of their program as well.

Our Idaho Affiliate, and others located in large, sparsely populated states, relies heavily on the use of preferred rate mail to supplement their staff program and fundraising activities. Many of these affiliates have only a few full-time staff members responsible for contacting volunteers and donors spread throughout their states as well as for carrying out their education and community program activities. For these affiliates, substantial increases in postal costs would be particularly hard to absorb.

Our Kansas Affiliate, like many others, conducts a very large-scale Cardiopulmonary Resuscitation (CPR) education program. This involves the distribution through the mail of a large volume of educational materials to schools and hospitals throughout Kansas. For this year alone they estimate their postage costs to be approximately $69,000 for this and other programs. The schools and hospitals pay for the CPR materials and their associated mailing costs, therefore, the CPR education program is financially self-sufficient at this time. Any increases in postage will have to be passed on to the Kansas schools and hospitals if they wish to continue to participate in this life-saving program. If the schools and hospitals are unable to incur the necessary additional costs, the Affiliate will have to consider a serious curtailment in the amount of CPR education materials they provide in their state.

Under the Administration's proposal our Michigan Affiliate would experience an increase in their third-class postage expenses from approximately $9,220 in 1985 to approximately $12,000 in 1986. The greatest impact of this increase would fall into this Affiliate's professional education program category.

These are only five examples of the effects that the Administration's proposal would have on the AHA and its affiliates. It is important to recognize that all 55 of our affiliates throughout the United States would experience similar cost increases.

As you know, the Postal Reorganization Act of 1970, and subsequent amendments to that Act, established a <u>permanent</u> funding mechanism for the "continuing appropriation" portion of the revenue forgone postal subsidy and a phasing schedule for the other portion designed to provide insulation for nonprofit mailers from substantial increases in their mail costs. The basic philosophy of the Act and its amendments is that postal rate increases for nonprofit mailers should be both

moderate and predictable. And most importantly, both the Act and its amendments reaffirmed that Congress has a continuing and legitimate role to play in postal rate making decisions.

Congress has been generous to the nonprofit sector during the past three years (FY 83-FY 85) by maintaining our rates at the step 14 of the phasing schedule. We should point out, however, that as of February 17, 1985 we experienced a rather substantial rate increase (approximately 15%) as a result of the implementation of the recent postal rate case. Based on the current phasing schedule, during FY 1986 our rates should increase to the step 15 level (as of October 1, 1985).

We are opposed to the Administration's proposals for FY 1986 because our rates would increase to the step 16 level which is higher than current law dictates. As you can see from the examples above, this is an increase which is unreasonable and one which we are unprepared to absorb. Furthermore, we do not believe that the Administration's plan to have the Postal Service absorb future costs of the revenue forgone postal subsidy is a workable solution to future funding for the subsidy. A proposal such as this would require substantial modification of current postal law and it is unlikely that such modifications would gain the support of the various groups of mailers or the approval of Congress. We support maintenance of the current phasing schedule and of the important role that Congress historically has played in the support of preferred rate mailers. Therefore, we respectfully request that your Subcommittee recommend full funding (approximately $981 million) for the revenue forgone postal subsidy for FY 1986.

AMERICAN BUSINESS PRESS

STATEMENTS OF:

RICHARD MOELLER, PRESIDENT, HBJ PUBLICATIONS, CLEVELAND, OH
ROBERT SALTZSTEIN, GENERAL COUNSEL, AMERICAN BUSINESS PRESS

Senator ABDNOR. We have asked the Budget Committee to include revenue forgone money. Only time will tell. It has been a problem. For awhile we robbed Peter to pay Paul. For awhile we took the money from other committees but it is almost $1 billion. That is a good part of our budget. Of course, that big budget battle will be starting tomorrow.

We thank you for attending and appreciate your testimony. If we want to and need to, we can always submit questions.

Thank you. Our next witnesses are Mr. Rich Moeller and Robert Saltzstein for the American Business Press.

Gentlemen, we welcome you to the committee. Your entire statement will be made a part of the record.

Mr. MOELLER. Mr. Chairman, members of the committee, my name is Richard Moeller. I am president of HBJ Publications in Cleveland, OH, a division of Harcourt, Brace, Jovanovich, Inc. I have worked in all aspects of the publishing business for 19 years. I am a member of the American Business Press Legal Committee. HBJ publishes over 100 medical, business, technical, agricultural, professional, and classroom journals. HBJ also publishes books.

We support the deletion from the budget of the $1 billion Postal Service subsidy, even though we will have to pay more postage for our agricultural publications, for our in-county circulation, for our classroom publications, and for books mailed at the library rate. The only exception we have to find with the Budget Committee is that $39 million for the blind and physically handicapped was deleted, we believe, by error. Hopefully that can be corrected by a technical amendment, but nothing else should be added to it. Once you go beyond that, you cannot stop.

The time has simply come for all of this mail to stand on its own two feet. Just as in private business, the rule of the marketplace should govern. Truly worthwhile charities will survive. Economic necessity, a sort of deregulation, will remove nonpostal in efficiencies in nonprofit organizations.

At a time when everything else is being cut, the American Business Press takes the following position: As between the possibility of reducing the deficit by this $1 billion and its effect on moderating any tax increase, we opt for deficit reduction because the fiscal integrity of the country requires it. Even if we have to pay more postage, we believe the ultimate result will be that of that the tax burden will be less.

I am accompanied today by ABP's general counsel, Robert Saltzstein, and I would like him to take the few remaining minutes of our time to give a little more of our views.

Mr. SALTZSTEIN. Mr. Chairman, I don't think all of our colleagues in the press will agree with our position, but I think they are nicely split. If you read the editorial columns of almost every paper, you see a call for deficit reduction. If you listen to the public side of some publishing enterprises, you will see arguments for the end subsidy rate. There comes a time when we can go no further when $1 billion is involved when $300 million was envisaged when the Postal Reorganization Act was enacted. There is a time to come to a halt. That is the reason that the American Business Press believes if there are to be subsidies, since we pay 100 percent of our postal costs, neither we nor others in the same position should be required to pay for these nonprofit mailings.

There is a congressionally established agency to consider what kind of mail should receive special consideration. That is the Postal Rate Commission. It has fully established legal procedures, approved by a U.S. Supreme Court decision under which the Commission can determine whether or not there should be any postal subsidies, the amount, if any,

who should and should not receive them. If an appropriation is then necessary, and we hope the Commission will conclude that there should be none except for the blind and handicapped, then let USPS temporarily foot the bill and require the Commission to come back to Congress in 6 months after a full hearing, with its recommendations.

Certainly there ought to be enough money in the $29 billion postal budget to make this possible. And 6 months should give the Commission ample time to conduct a hearing at which all the interested parties will hear. We cannot believe that out of a budget of $29 billion a way cannot be found.

There is nothing sacrosanct about profitmaking businesses, and there should be nothing sacrosanct about the profitmaking business activities of the nonprofit organizations either. In fact, there are many abuses. The way to stop this is to do just that, stop it, let it be considered by the impartial Commission established for just this purpose, and put things on hold pending their hearing.

That will be in line with the legislative history of the Postal Reorganization Act. Indeed, one of the compelling reasons for changing the system in 1970, a system gradually evolving successfully, was to reduce the political role in the Postal Service. Yet, here we are working to fend off a budget busting postal raid on the Treasury. We urge you to say no more.

In furtherance of what I just said, I am turning to page 21712 of the hearing held—floor debate held June 26, 1970, in the Senate when Senator Magee of Wyoming said, let me say if we amend this bill for one preferrable rate for any group, we might as well cave in entirely. The committee decided and we earnestly recommend that all statutory preferences be abolished, that Congress get out of the ratemaking business. To do otherwise is to pass a postal reform bill that is truly no reform at all in the ratemaking field but remains hollow indeed.

Mr. Chairman, today, we have the highest regard for all nonprofit organizations. We do not think they ought to be in business activities. We think they ought to pay the full amount of postage. It has been extended once when the nonprofit rate went from an 8-year phasing to a 16-year phasing and here we are asking Congress to get in the ratemaking business. We urge you to send this thing to the Postal Rate Commission.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF RICHARD MOELLER

My name is Richard Moeller. I am President of HBJ Publications, Cleveland, Ohio, a division of Harcourt Brace Jovanovich, Inc. I have worked in all aspects of the publishing business for 19 years. I am a member of the American Business Press Legal Committee. HBJ publishes over 100 medical, business, technical, agricultural, professional and classroom journals. HBJ also publishes books.

We support the deletion from the budget of the $1 billion dollar postal service subsidy, even though we will have to pay more postage for our agricultural publications, for our in-county circulation, for our classroom publications and for books mailed at the library rate. The only fault we have to find with the Budget Committee is that $39 million dollars for the blind and physically handicapped was deleted, we believe by error. Hopefully that can be corrected by a technical amendment, but nothing else should be added to it. Once you go beyond that, you cannot stop.

The time has simply come for all of this mail to stand on its own two feet. Just as in private business, the rule of the marketplace should govern. Truly, worthwhile charities will survive; economic necessity, a sort of deregulation, will remove non-postal inefficiencies in nonprofit organizations.

At a time when everything else is being cut, the American Business Press takes the following position: As between the possibility of reducing the deficit by this billion dollars and its effect on moderating any tax increase, we opt for deficit reduction because the fiscal integrity of the country requires it. Even if we have to pay more postage, we believe the ultimate result will be that the tax burden will be less.

I am accompanied today by ABP's General Counsel, Robert Saltzstein and I would like him to take the few remaining minutes of our time to give a little more of our views.

ROBERT A. SALTZSTEIN

Members of the Committee:

Mr. Moeller has stated the American Business Press position: We know that attempts will be made to restore this billion in whole or in part. We do not like differing with some of our colleagues in the press, indeed, nonprofit mailers, about it. But apparently we do differ. We know however that many of those colleagues take the same position we do: All one has to do is look at the editorials in practically every paper in the country. Almost without exception, they call for deficit reduction. How can the deficit be reduced without eliminating the postal subsidy, probably the lowest priority on the totempole of Government activities.

There is a very good way to handle this whole situation so that there is no barrage of special pleadings from one charity, university, hospital, or whatever. That is to provide in your legislation that as of this date, nonprofit appropriations are eliminated except for Section 3403 of the Postal Reorganization Act. This is mail for the blind and physically handicapped where $39 million dollars is required. Beyond that, ABP believes all postal subsidies should be discontinued.

We also believe that if there are to be subsidies, since we pay 100% of our postal costs, neither we nor others in the same position should be required to pay for these nonprofit mailings.

There is a Congressionally established agency to consider what kind of mail should receive special consideration. That

is the Postal Rate Commission. It has fully established legal procedures, approved by a United States Supreme Court decision, [1] under which the Commission can determine whether or not there should be any postal subsidies, the amount if any,who should or should not receive them. If an appropriation is then necessary, and we hope the Commission will conclude that there should be none except for the blind and handicapped, then let USPS temporarily foot the bill and require the Commission to come back to Congress in 6 months, after a full hearing, with its recommendations.

Certainly there ought to be enough money in the $29,000,000,000 postal budget to make this possible. And 6 months should give the Commission ample time to conduct a hearing at which all the interested parties will appear. A draft of our legislative proposal is attached. We cannot believe that out of a budget of $29 billion a way cannot be found.

What was estimated in 1970 to cost 300 million is now $1 billion. Every year the Government pays $1 billion dollars in interest on the $10 billion spent for postal subsidies, accrued since 1970 alone.

There is nothing sacrosanct about profit making businesses, and there should be nothing sacrosanct about the profitmaking business activities of nonprofit organizations either. In fact, there are outright abuses. The way to stop this is to do just that, stop it, let it be considered by the impartial Commission established for just this purpose, and put things on hold pending their hearing.

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1 National Association of Greeting Card Publishers v. United States Postal Service, 103 S.Ct. 2717 (1983).

That will be in line with the legislative history of the Postal Reorganization Act. Indeed, one of the compelling reasons for changing the system in 1970, a system gradually evolving successfully, was to reduce the political role in the Postal Service. Yet, here we are working to fend off a budget-busting postal raid on the Treasury. We urge you to say -- No More.

Senator ABDNOR. Thank you, gentlemen. We appreciate your background information. I have this Postal Simplification and Self-sufficiency Act. Do you want that a part of the record?

Mr. SALTZSTEIN. Yes; Mr. Chairman.

Senator ABDNOR. This committee would be severely criticized if we started legislation out of here.

We thank you for much for your views on this and it will be considered along with the others.

[The information follows:]

POSTAL SIMPLIFCATION AND SELF-SUFFICIENCY ACT OF 1985

SEC. 1. Section 3626 of title 30 of the United States Code is hereby repealed.

SEC. 2. Section 3627 of title 39 of the United States Code is amended by striking out the words "or 3626 of title".

EXPLANATION

The effect of the repeal of section 3626 of title 30 would be to eliminate all preferred postal rate categories from the United States Code. Thus, there would no longer be statutory authorization for taxpayer subsidization of any type of mail sent by either for-profit or nonprofit organizations. Diplomatic mail (which is subject to reciprocity) and free mail for the blind and handicapped as specified in section 3627 would continue to be sent free of charge in a separate appropriation. This amount is $39 million per year.

Under existing section 3623 of title 39, the Postal Rate Commission would assume jurisdiction over whether or not special categories are necessary for preferred rate subclasses now the beneficiaries of nearly $1 billion of taxpayer subsidy. The Commission would hold hearings. Interested members of the public could participate in a hearing under section 3623.

The Commission could, if it so chose, recommend to the Postal Service either complete merger of the current nonprofit and preferred rate categories with the regular rate categories (second-, third-, and fourth-class) or it could recommend separate rates for each subclass.

The Commission would use the same ratemaking criteria in sections 3622 and 3623 of title 39 in establishing rates for currently subsidized mail as for regular rate mailers.

This proposed change would (1) eliminate all taxpayer subsidization and (2) prevent cross-subsidization of nonprofit mail by regular rate mailers including the general public.

This legislation adopts the approach taken by the Senate in 1970 when it passed S. 3842 which would have eliminated all revenue forgone appropriations. At that time the revenue forgone appropriation was estimated to be $300 million on an annual basis. The Senate Post Office Committee report accompanying S. 3842 predicted that if that legislation were not passed, the volume of nonprofit mail would greatly increase and thus the cost to the taxpayer.

In fact, because the Senate elimination of the nonprofit legislation was not passed, the current revenue forgone annual appropriation is $1 billion, over three times what the 1970 estimate was.

As stated above, diplomatic mail and free mail for the blind would continue as separately appropriated categories.

NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS

STATEMENT OF CLAIRE ARNOLD, PRESIDENT, NEWTON TOBACCO CO., ATLANTA, GA, AND MEMBER, BOARD OF DIRECTORS

Senator ABDNOR. James Peirce, president of the National Federation of Federal Employees.

Is Mr. James Peirce in the room?

If not, we will move on to Ms. Claire Arnold of the National Association of Tobacco Distributors.

First, we welcome you to the committee.

Ms. ARNOLD. This is Rob Watkin.

Mr. Chairman and members of the subcommittee, my name is Claire Arnold, president of Newton Tobacco Co., Atlanta, GA.

I am a member of the board of directors of the National Association of Tobacco Distributors.

Representatives of our association have appeared before your subcommittee in prior years to present their concerns regarding appropriations for the Treasury Department and, in particular, the impact which the funding level for the Bureau of Alcohol, Tobacco and Firearms has on our industry. There is no other national trade association besides ours with a membership more directly affected by the decisions, regulations and enforcement functions of the tobacco part of the ATF.

Mr. Chairman, the association opposes the recommended budget for ATF tobacco law enforcement functions contained in the Department of the Treasury fiscal year 1986 justification for appropriations, submitted to this subcommittee for consideration. The ATF has recommended funding this function at $848,000 for fiscal year 1986, which would be a reduction of $3.337 million from the fiscal year 1985 level. The ATF indicated that major responsibility for this program will be transferred to the states. The ATF fiscal year 1986 workload in cigarette contraband enforcement would involve only six investigations and there would only be two suspects targetted for prosecution.

The NATD believes that the administration is wrong in virtually eliminating the enforcement function under this ATF activity, and that the proposed expenditure of $848,000 for the prosecution of only two suspects is ludicrous. This reduced funding shows a lack of understanding as to what is really happening throughout the United States in cigarette smuggling. Reducing the Cigarette Contraband Enforcement Program at ATF from 56 positions to 11 positions, and including the recommended cuts is opposed by the NATD. We recommend maintaining this program at the fiscal year 1985 level of $4.185 million with 56 positions dedicated to the cigarette contraband enforcement function.

Cigarettes are a significant revenue source for the Federal Government budget, with an estimated $4.7 billion in revenue expected during fiscal year 1985. It seems altogether fitting and proper that the Federal Government does its fair share to ensure that the distribution system for cigarettes in the United States is free from pressures of smuggling, bootlegging, and organized crime. Appropriations for the ATF in the amount of $4.185 million for fiscal year 1986 is the least that could be

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done given the magnitude of the revenue contributions made by the Federal cigarette excise tax.

Yet, there are many other policy justifications for continued funding of ATF tobacco enforcement functions beyond the fact that cigarette excise taxes produce such a large revenue.

In March 1985 the Advisory Commission on Intergovernmental Relations, ACIR, released its year by year study on cigarette tax evasion. It was as an update of an earlier report on this subject released by the ACIR in 1977, and this earlier report contributed to the congressional adoption of the 1978 Contraband Cigarette Act. This subcommittee directed the ACIR in 1983 to develop current estimates of cigarette tax losses, particularly those losses attributable to organized interstate smuggling, and to recommend what actions the national or State governments could take to further reduce these losses.

The following conclusions from the ACIR 1985 report point to continuing the present funding level for cigarette contraband enforcement. The Commission recommends that the Congress continue to fund the Tobacco Enforcement Program of the ATF. A continuous Federal law enforcement presence is needed to maintain the gains made against cigarette smuggling to keep organized crime involvement in check and to protect legitimate cigarette wholesalers and retailers.

The Commission recommends that Congress closely monitor organized interstate cigarette smuggling activities in the States and provide additional Federal law enforcement resources if the level of such activity appears to be rising.

The Commission is concerned that some States are using Federal actions to justify reducing their role in enforcing cigarette tax laws. This could be an open invitation for an increase in cigarette smuggling.

The ACIR also made some significant recommendations in the area of Indian reservations and military sales. I would like permission to insert, at the conclusion of my remarks, chapter 1 of the ACIR report, pages 1 to 8, on findings and recommendations.

The Commission determined that the amount of revenue lost by State and local governments due to cigarette tax evasion is estimated at $255 million for fiscal year 1983, down from an estimated total of $400 million in 1975. The results of a survey conducted by the ACIR for this report is even more revealing. This survey was directed to each of the 50 State cigarette tax administrators. The results appear in appendix B of the 1985 ACIR report. Two significant findings are, first, four States indicated that they have evidence of organized crime involvement in cigarette smuggling or counterfeiting in this State; second, nine States said they had a worse problem in the past 5 years relating to cigarette tax evasions.

These findings and others in the ACIR report indicate that the circumstances which foster cigarette tax evasion schemes have not been eliminated, but rather have been enhanced, and hence, there is a greater motive for the resurgence of this activity. The only solution is a continued Federal presence in the tobacco enforcement area. The Fed-

eral presence is a deterrent to organized crime, and assistance to State enforcement authorities, and the only means to control a problem which is, by definition, an interstate problem.

The basic cause of cigarette smuggling is the disparity in State and local cigarette tax rates, which produce the incentives for smuggling and bootlegging. These excise taxes continue to rise on a State and local level.

The Illinois Candy and Tobacco Association informs us that the Illinois director of revenue recently estimated losses in revenue to the State of over $25 million annually due to cigarette bootlegging and hijacking. The situation in Illinois is not unique, according to our tobacco wholesaler members located around the country. For example, in New York a major tobacco wholesale company had five hijackings in 4 weeks and now maintains armed guards in its warehouses to prevent cigarette smuggling.

Mr. Chairman, if I were in the organized crime family, I would be pleased to see the end of Federal cigarette contraband enforcement functions. In fact, I would encourage a further reduction to virtually eliminate all agents, investigations, and programs in this area. However, we at NATD strongly believe that now is not the time to reduce this law enforcement function.

Therefore, we urge the subcommittee to appropriate $4.185 million for fiscal year 1986 for cigarette contraband enforcement area in the Bureau of Alcohol, Tobacco and Firearms. Funding at this level, which is the same as of that fiscal year 1985, will allow ATF to fulfill its important responsibilities.

Thank you.

PREPARED STATEMENT

Senator ABDNOR. Thank you.

You know the problem. We do too. We were the ones that requested that study you referred to. We have it and we did a thorough job of going through it. I need not tell you, our budget will see much that needs to be corrected. We are aware of the problem and have a great appreciation of the work that the BATF does. I think the record shows we do the best we can with our limitations.

Thank you very much.

[The statement follows:]

STATEMENT OF CLAIRE ARNOLD

Mr. Chairman and Members of the Subcommittee, my name is Claire Arnold, President of Newton Tobacco Company, Inc., Atlanta, GA. I am a member of the Board of Directors of the National Association of Tobacco Distributors (NATD), which represents over 570 corporate wholesaler-distributor members with over 740 distribution outlets, and represents 230 manufacturer and supplier associates whose 12,000 salesmen canvass and supply almost 1.5 million retail outlets selling tobacco products across the United States. It is estimated that members of the Association's trade and industry market goods with an annual wholesale value of over $16.0 billion dollars.

Representatives of the association have appeared before your Subcommittee in prior years to present their concerns regarding appropriations for the Treasury Department and, in particular, the impact which the funding level for the Bureau of Alcohol, Tobacco and Firearms (ATF) has on our industry. There is no other national trade association besides ours with a membership more directly affected by the decisions, regulations and enforcement functions of the tobacco part of the ATF.

Mr. Chairman, the Association opposes the recommended budget for ATF tobacco law enforcement functions contained in the Department of the Treasury Fiscal Year 1986 Justification For Appropriations, submitted to this Subcommittee for consideration. The ATF has recommended funding this function at $848,000 for Fiscal Year 1986, which would be a reduction of $3.337 million from the Fiscal Year 1985 level. The ATF indicated that "major responsibility for this program will be transferred to the states." The ATF FY 86 work load in cigarette contraband enforcement would involve only six investigations and there would only be two suspects targeted for prosecution.

The NATD believes that the Administration is wrong in virtually eliminating the enforcement function under this ATF

activity, and that the proposed expenditure of $848,000 for the prosecution of only two suspects is ludicrous. This reduced funding shows a lack of understanding as to what is really happening throughout the United States in cigarette smuggling. Reducing the cigarette contraband enforcement program at ATF from 56 positions to 11 positions, and including the recommended cuts, is opposed by the NATD. We recommend maintaining this program at the Fiscal Year 1985 level of $4.185 million with 56 positions dedicated to the cigarette contraband enforcement function.

In the budget request to this Subcommittee, the ATF indicated that "This program decrease responds to the recommendation of the Senate Appropriations Committee Report 98-562, dated July 17, 1984 to reduce this program." But that report, as you know, Mr. Chairman, made no such recommendation. In fact, Senate Report 98-562, on page 12 under "Cigarette Smuggling," recommended a reduction of only $2.1 million, leaving over $2 million in the program, not the $848,000 as recommended this year by the Administration. The ATF also ignores two congressional facts: (1) This reduction in Fiscal Year 1985 funds was reversed by the Conference Committee resulting in full funding for this program and (2) House Report 98-830, for Fiscal Year 1985 directed the Bureau to "Continue assisting the States in this important Program in 1985 at the same level provided to the States in 1984."

Cigarettes are a significant revenue source for the federal government budget, with an estimated $4.7 billion in revenue expected during FY 1985. It seems altogether fitting and proper that the federal government does its fair share to ensure that the distribution system for cigarettes in the United States is free from the pressures of smuggling, bootlegging and organized crime. Appropriations for the ATF in the amount of $4.185 million for FY 1986 is the least that could be done given the magnitude of the revenue contributions made by the federal cigarette excise tax.

Yet there are many other policy justifications for continued funding of ATF tobacco enforcement functions beyond the fact that cigarette excise taxes produce such a large revenue.

In March, 1985 the Advisory Commission on Intergovernmental Relations (ACIR) released its year by study on "Cigarette Tax Evasion." It was as an update of an earlier report on this subject released by the ACIR in 1977, and this earlier report contributed to the congressional adoption of the 1978 Contraband Cigarette Act. This Subcommittee directed the ACIR in 1983 to develop current estimates of cigarette tax losses, particularly those losses attributable to organized interstate smuggling, and to recommend what actions the national or state governments could take to further reduce these losses. Throughout the past year the NATD participated in the development of this ACIR report and have fully endorsed its findings and recommendations.

I am sure, Mr. Chairman, that you and your staff know of the outstanding reputation for research that the ACIR has as well as its distinguished membership which includes citizens, governors, mayors, state legislators, county officials, and six colleagues from the Congress: Senators David Durenberger (R-MN), James Sasser (D-TN), William Roth (R-DE), and Congressmen Robert Walker (R-PA), Theodore Weiss (D-NY), and Barney Frank (D-MS).

The following conclusions from the ACIR 1985 Report point to continuing the present funding level for cigarette contraband enforcement:

- The Commission recommends that the Congress continue to fund the tobacco enforcement program of the ATF...A continuous federal law enforcement presence is needed to maintain the gains made against cigarette smuggling to keep organized crime involvement in check and to protect legitimate cigarette wholesalers and retailers;

- The Commission recommends that Congress closely monitor organized interstate cigarette smuggling activities in the states and provide additional federal law enforcement resources in the level of such acting appears to be rising; and

- The Commission is concerned that some states are using federal actions to justify reducing their role in enforcing cigarette tax laws. This could be an open invitation for an increase in cigarette smuggling.

The ACIR also made some significant recommendations in the area of Indian Reservations and military sales. I would like permission to insert, at the conclusion of my remarks, Chapter One of the ACIR Report, page 1-8, on findings and recommendations.

The Commission determined that the amount of revenue lost by state and local governments due to cigarette tax evasion is estimated at $255 million for Fiscal Year 1983, down from an estimated total of $400 million in 1975. The results of a survey conducted by the ACIR for this report is even more revealing. This survey was directed to each of the 50 state cigarette tax administrators. The results appear in Appendix B (pages 79-82) of the 1985 ACIR Report. Two significant findings are:

- Four states indicated that they have evidence of organized crime involvement in cigarette smuggling or counterfeiting in this state;
- Nine states said they had a worse problem in the past five years relating to cigarette tax evasions.

Those findings and others in the ACIR report, indicate that the circumstances which foster cigarette tax evasion schemes have not been eliminated, but rather have been enhanced; and hense there is a greater motive for the resurgence of this activity. The only solution is a continued federal presence in the tobacco enforcement area. The federal presence is a deterrent to organized crime, and assistance to state enforcement authorities, and the only means to control a problem which is, by definition, an interstate problem.

In May, 1977, which was prior to passage of the Cigarette Contraband Act, Time Magazine published an in-depth issue concerning organized crime that showed cigarette bootlegging as

one of the top six rackets, producing annual gross revenues of $1.5 billion for organized crime. We cannot allow this nation to return to the 1970s by removing funding from ATF tobacco enforcement program.

The basic cause of cigarette smuggling is the disparity in state and local cigarette tax rates, which produce the incentive for smuggling and bootlegging. These excise taxes continue to rise on a state and local level. For example, the price for a pack of cigarettes in Chicago includes 16 cents federal tax, 12 cents state tax, 15 cents city tax and 8 cents county tax, for a total of 51 cents in excise taxes while the price of a pack of cigarettes from the neighboring State of Kentucky includes only 16 cents federal tax and a mere 3 cents state tax for a total of 19 cents in excise taxes. A bootlegger would receive a profit of 32 cents for every pack of cigarettes which was purchased in Kentucky, trucked to Chicago and sold at the same price as similar packs sold through legitimate channels.

Thus, a bootlegger makes $3.20 per carton (10 packs per carton), $192 per case (60 cartons in a a case) or $153,600 (800 cases) per semi-trailer load of smuggled cigarettes. This incentive for smuggling exists in every state which has high cigarette excise taxes.

However, bootlegging is not the only type of cigarette tax evasion scheme. There has been an increase in the incentive for counterfeiting cigarette tax stamps, for such a practice, using the Chicago-area rates again as an example, could yield $153,600 in illegal profits per semi-truckload. Likewise, the incentive to steal cigarettes and hijack trucks which haul cigarettes has also increased due to higher federal, state and local excise taxes. The total value of stolen cigarettes without state cigarette stamps has increased (using the Chicago-area again as an example) to about $380,160 per semi-truckload ($7.92 per carton).

The Illinois Candy and Tobacco Association informs us that the Illinois Director of Revenue recently estimated losses in revenue to the state of over $25 million annually due to cigarette bootlegging and hijacking. The situation in Illinois is not unique, according to our tobacco wholesaler members located around the country. For example, in New York a major tobacco-wholesale company had five hijackings in four weeks and now maintains armed guards in its warehouses to prevent cigarette smuggling.

Mr. Chairman, if I were in the organized crime family, I would be pleased to see the end of federal cigarette contraband enforcement functions. In fact, I would encourage a further reduction to virtually eliminate all agents, investigations and programs in this area. However, we at NATD strongly believe that now is not the time to reduce this law-enforcement function.

Therefore, we urge the Subcommittee to appropriate $4.185 million for Fiscal Year 1986 for the cigarette contraband enforcement area in the Bureau of Alcohol, Tobacco and Firearms. Funding at this level, which is the same as that of Fiscal Year 1985, will allow ATF to fulfill its important responsibilities.

[COMMISSION REPORT]

CIGARETTE TAX EVASION: A SECOND LOOK

CHAPTER 1

FINDINGS AND RECOMMENDATIONS

Cigarette tax evasion began to pose serious problems for state tax administrators in the late 1960s. There had always been some casual smuggling across state lines and some problems with mail order sales of cigarettes, but large-scale organized smuggling was practically nonexistent. Organized smuggling emerged as tax rate differentials among the states began to widen in the mid-1960s. In 1965 New York doubled its cigarette tax rate from 5 cents to 10 cents and other states began to follow suit. The cigarette tax became an attractive revenue source for the states in the wake of the 1964 report of the U.S. Surgeon General linking smoking with cancer. Although not a major revenue source it became politically convenient for states to fill small gaps in their budgets with increased cigarette tax revenues. In 1960, cigarette tax rates ranged from 0 in Virginia, North Carolina and Oregon to 8 cents in Texas. The rates for the vast majority of states were between 2 and 6 cents. By 1970, tax rates ranged from 2 cents in North Carolina to 18 cents in Pennsylvania and well over half the states levied rates of 10 cents or more. These tax differentials continued to widen through the mid-1970s.

The large state tax differentials created inviting profit opportunities for independent "entrepreneurs" and organized crime groups. The large profit potential combined with the ease of handling cigarettes, the limited resources allocated by the states to law enforcement, the light penalties imposed by the courts and the lack of federal laws against cigarette bootlegging, resulted in an epidemic of organized cigarette smuggling and illegal diversion of cigarettes from the legal distribution system by the mid-1970s.

The most visible consequence of cigarette tax evasion is the loss of revenues to state and local governments—estimated by ACIR at about $400 million in 1975. This revenue loss is what most concerns state tax administrators. The consequences of cigarette tax evasion, however, extend beyond the loss of government revenues. The impact on the tobacco industry has been particularly severe. Thousands of wholesalers and retailers in the high-tax states have gone out of business and jobs have been lost because of their inability to compete with individuals selling lower priced, smuggled cigarettes. The industry has also been damaged by distributors who felt the economic need to deal in illegal cigarettes. On another level, political and law enforcement officials have been corrupted and some persons have been injured and even killed.

State law enforcement officials were unable to deal effectively with this problem because of its interstate nature and because state legislatures were unwilling to appropriate adequate funds for law enforcement. There were some who felt the only way to deal with the problem was for Congress to pass legislation that would coerce the states to adopt uniform cigarette tax rates. This approach was strongly opposed by the tobacco industry because it entailed higher taxes and by many state tax administrators and politicians because it constituted federal interference in state tax matters. At the other extreme were persons who favored the status quo either because they believed cigarette smuggling was not a serious problem or because they believed the problem was created by the high-tax states which could solve their own problem by reducing their cigarette tax rates. Most state tax administrators and law enforcement officials favored Congressional legislation making cigarette smuggling a federal crime.

In 1978, the Congress enacted PL 95-575 which prohibited the transportation, receipt, shipment, possession, distribution or purchase of more than 60,000 cigarettes not bearing the tax indicia of the state in which the cigarettes are found. The impact of this legislation on cigarette smuggling appears to be greater than even its strongest advocates expected. It is, however, too soon to proclaim a complete, long-term victory over cigarette smuggling as many of the conditions that encouraged large-scale tax evasion in the 1970s still remain. There have been substantial increases in state cigarette tax rates in the last three years and there is some evidence that cigarette smuggling increased in 1983, albeit modestly. The withdrawal or diminution of the federal law enforcement presence might encourage increased cigarette tax evasion activity.

The National Association of Tax Administrators (NATA) summarized the current situation well in testimony before Congress in 1982:

> We pointed out that cigarette smuggling is by its very nature an interstate activity which can be dealt with effectively only by a federal presence. We also pointed out that the *Contraband Cigarette Act* is an unusually successful law, in that it has been highly effective in reducing the volume of smuggling sharply and quickly; and it forestalled a growth in smuggling during a period of recession when this illegal activity could be expected to flourish. Nevertheless, we emphasized, the experience of New York and a number of other states where smuggling incidents have occurred indicates that this illegal activity is still present and could accelerate easily. We said that the minimal federal presence requested by the ATF would retain the gains that had been made and prevent a new outburst in smug-

gling, and we stressed that if that minimal federal presence were removed, a massive resurgence in smuggling could occur very quickly. The recent widespread rise in cigarette tax rates was cited as a new incentive for such a revival.[1]

SUMMARY OF FINDINGS AND CONCLUSIONS

The major findings of this study follow.

- *Cigarette smuggling has declined dramatically since the 1970s, particularly large-scale organized smuggling* (see Map 1-1). The amount of revenue lost by state and local governments due to tax evasion and tax exemption is estimated at $255 million for FY 1983; the amount lost by the "losing" states is $309 million. This is 5.4 percent of estimated cigarette tax collections, a 45 percent decline from the 10 percent lost by these governments in 1975. In its 1977 report on cigarette bootlegging, ACIR identified 14 states as having a serious bootlegging problem. In 1983 only Connecticut and West Virginia could be placed in this category, and the losses in these states are more likely due to casual than organized smuggling. (This categorization excludes tax exempt sales which were not segregated in the earlier study, but are treated separately in this report.)

- *An estimated 70 percent of the revenue lost by state and local governments results from tax exemption of sales on Indian reservations and military bases.* These exemptions are the major source of the revenue loss on cigarettes in 26 states. The estimated loss was $219 million in FY 1983. The tax exemption for military sales cost state and local governments an estimated $176 million in FY 1983. Of this amount, about 31 percent, or $54 million, can be attributed to the illegal sale of cigarettes to nonmilitary personnel. Although this tax exemption was listed in the 1984 ACIR survey on cigarette tax evasion as the major tax evasion problem by seven states, there is no evidence that this problem has increased in severity in recent years. In contrast, tax-exempt sales on Indian reservations, which was listed as the major problem by five states, appears to be becoming a more serious problem in a number of states despite favorable (for the states) court rulings in recent years.

- *The decline in cigarette tax evasion activities is due mainly to the enactment of the Federal Cigarette Contraband Act in 1978.* The enforcement agency, the Bureau of Alcohol, Tobacco, and Firearms (U.S. Treasury Department) has been extremely effective in stopping over-the-road smuggling, as well as in reducing the illegal diversion of cigarettes. It is also possible that the reduction in smuggling is partly due to the declining real value of interstate price differences that began in the mid-1970s and continued until 1981, and the increasing cost of smuggling.[2] The major gains against cigarette smuggling were made between 1978 and 1980. Between 1980 and 1983 there was a relatively small decline in cigarette bootlegging.

  There have been numerous state tax increases since 1981 and state cigarette tax differentials, which are the primary cause of cigarette smuggling, have widened in the last few years (see Map 1-2). These tax differentials, combined with the slowdown in inflation, have caused a sharp increase in real cigarette price differences among the states, creating the potential for a resurgence of cigarette smuggling in the future if law enforcement efforts become less effective.

- *Many states have reduced the resources devoted to enforcing state cigarette tax laws.* These reductions have been due largely to budget problems, the decline in cigarette smuggling, and increased reliance on federal law enforcement. These reductions may be justified given the sharp decline in organized smuggling, but a significantly reduced effort or a lack of continuity in law enforcement (including auditing) at the national or state level is an invitation for increased cigarette smuggling.

- *The empirical analysis in this report indicates that tax-related variables significantly affect per capita sales variations among the states, but this effect has weakened in recent years.* Higher prices are still associated with low per capita sales and vice versa, but the price elasticity of cigarettes (in an individual state) has declined sharply since the mid-1970s, due largely to the reduction in tax evasion activities. State per capita sales are converging toward the mean and the remaining variations are largely due to social, economic, and demographic factors such as religion, income and ethnic composition.

RECOMMENDATIONS ON CIGARETTE BOOTLEGGING

Federal Enforcement Efforts

The Commission concludes that the incidence of cigarette smuggling has declined significantly since 1977, due in large part, to the passage of the Federal Contraband Cigarette Act in 1978. Because tax differentials among states remain large, however, the removal of this federal enforcement presence could result in a resurgence of cigarette smuggling. The Commission therefore recommends that the Congress continue to fund the tobacco enforcement program of the Bureau of the Alcohol, Tobacco and Firearms (ATF).

The conclusion that cigarette bootlegging has declined since the mid-1970s is based on observations in the field by federal and state enforcement agents and on statistical evidence. In its 1977 report, ACIR identified 14 states as having a serious cigarette bootlegging problem and 9 states as ben-

Map 1-1

REDUCTION IN CIGARETTE TAX EVASION IN PACKS PER CAPITA, 1975-83

SOURCE: ACIR staff estimates

[1]Delaware and Rhode Island changed from modest losses to large gains.
[2]A significant increase in tax evasion (four packs per capita) or more occurred in Alaska, D.C., Michigan, Nevada, Oklahoma, Oregon, South Carolina, Utah, Virginia and West Virginia. Several of these states changed from winners to losers.
[3]Idaho, Indiana, Kentucky, New Hampshire, North Carolina experienced reduced gains from cigarette tax evasion. Increased gains occurred in only Vermont and Wyoming.
[4]Per capita gains and losses for each state are shown in *Table 5-5*.

Map 1-2

INCREASES IN STATE CIGARETTE TAX RATES, IN CENTS PER PACK, JANUARY 1, 1981, TO JULY 1, 1984

SOURCE: The Tobacco Institute, *The Tax Burden on Tobacco*, Vol. 18, 1983, and Commerce Clearing House, *State Tax Review*, 1984 issues.

[1]The cigarette tax rate in Maine will increase an additional 8¢ on October 1, 1985. The tax rate in Texas will increase an additional 1¢ on September 1, 1985. The tax rate in Kansas will increase 8¢ on October 1, 1989, if the federal tax rate is reduced by 8¢.

[2]The state sales tax was extended to cigarettes in Maine, Minnesota, Ohio, Oklahoma, Pennsylvania and Texas adding from 3¢ to 6¢ per pack.

eficiaries of bootlegging. In fiscal year 1976, per capita cigarette sales in the 14 states with a bootlegging problem averaged 90.1 percent of the U.S. average. By fiscal year 1982, per capita sales in these states had risen to 95.3 percent of the U.S. average. (In fiscal year 1983, per capita sales fell to 94 percent of the U.S. average, due most likely to tax increases in many states and some distortions in the figures caused by the doubling of the federal cigarette excise tax.) In fiscal year 1976, per capita cigarette sales in the nine states gaining from cigarette bootlegging was 142 percent of the U.S. average. In fiscal year 1983, per capita cigarette sales in these states fell to 124.4 percent of the U.S. average. In all nine states per capita cigarette sales were at or very near their peak during the 1976-78 period.

It is no coincidence that the ACIR report on cigarette bootlegging was published and the federal *Contraband Cigarette Act* passed during this period. An additional piece of statistical evidence supporting the conclusion that cigarette smuggling has declined is provided by the coefficient of variation of per capita cigarette sales. This measures the degree of variation from the mean. In fiscal year 1975, the coefficient of variation was 8.56 packs. This measure of variation fell to 5.5 packs in fiscal year 1980 and 4.94 packs in fiscal year 1983. In other words, the variation in taxable cigarette sales among the states has become much smaller. One of the main reasons for variations among states is cigarette smuggling; other factors are tourism, income, and social and demographic differences. There is little evidence that these other factors have changed significantly; therefore, it seems reasonable to conclude that the variation in per capita cigarette sales among the states has declined because of reduced cigarette bootlegging.

Most conclusive is the major finding of this study that the estimated amount of cigarette tax evasion has declined about 45 percent since 1975 and about 70 percent of the remaining amount is due to tax-exempt sales on Indian reservations and military bases.

The ATF has made an important contribution in promoting more uniform law enforcement among the states, in coordinating interstate investigations and in improving the training of state and local law enforcement personnel. A continuous federal law enforcement presence is needed to maintain the gains made against cigarette smuggling, to keep organized crime involvement in check and to protect legitimate cigarette wholesalers and retailers.

Congressional Monitoring

The Commission concludes that the level of cigarette bootlegging could increase again if the tax differentials among the states continue to increase. The Commission therefore recommends that Congress closely monitor organized interstate cigarette smuggling activities in the states and provide additional federal law enforcement resources if the level of such activity appears to be rising.

In the 1970 to 1975 period there were 34 increases in state cigarette taxes. This large number of increases coincided with a substantial rise in the level of cigarette bootlegging. In the 1975 to 1980 period there were only 12 increases in state cigarette tax rates (and one tax reduction). During the 1980-83 period there were 31 tax increases (and one reduction) as the weak economy put pressure on state finances.

In 1970 the largest state tax differential was 16 cents. By 1975 the largest differential had increased to 19 cents and remained at this level until 1982, when the largest state tax differential increased to 23 cents. The ACIR concluded in its 1977 report that a 10-cent tax differential appeared to be the point at which cigarette smuggling became profitable enough to attract organized criminal elements. This "flashpoint" has likely risen because inflation has increased the costs associated with cigarette smuggling. A 23-cent differential, however, offers a very attractive profit opportunity for organized smuggling operations.

The tobacco producing states are unlikely to increase their tax rates. Therefore, further tax increases by high-tax states will increase state tax differentials and could cause a resurgence of cigarette bootlegging without an increased federal law enforcement presence.

State Enforcement Efforts

The Commission concludes that the states have cut back the resources devoted to enforcing cigarette tax laws. The major reasons for the reductions are budget problems and the success of the federal enforcement effort in reducing cigarette smuggling. When the federal *Contraband Cigarette Act* was passed in 1978, Congress expressed concern that the states would reduce their law enforcement efforts and place the major burden on the national government. **The Commission is concerned that some states are using federal actions to justify reducing their role in enforcing cigarette tax laws. The Commission therefore recommends that the states maintain an active law enforcement presence and that when tax rates are increased consider allocating a portion of the additional revenue generated for law enforcement.**

It may be logical to reduce enforcement efforts when cigarette smuggling declines, but severe reductions could be an open invitation for an increase in cigarette smuggling. The states must begin to think of enforcement activities as preventive. Such activities as regular auditing are important to keep cigarette smuggling in check even if no immediate revenue is generated by the audits. A continuous, visible law enforcement effort by the states is necessary if the progress made against cigarette smuggling in the last few years is to be maintained.

Exemption of Military Sales

The Commission concludes that the illegal purchase of cigarettes from military installations for consumption by nonmilitary personnel is a problem. The Commission recommends, that as a beginning, military officials work closely with appropriate state and federal officials to further reduce incidences of cigarette bootlegging on military installations.*

The exemption of cigarettes sold on military bases from state and local taxes has been a major concern to state tax administrators for a number of years. Tax administrators are concerned about the revenue loss on legal tax exempt sales, but are even more concerned about revenues lost because of illegal sales to nonmilitary personnel.

In ACIR's 1984 survey of cigarette tax administrators, seven states listed military privilege abuses as their most serious tax evasion problem and four states listed it as their second most serious problem.

The revenue loss to state governments from the military sales exemption on cigarettes is estimated at $177 million (fiscal year 1983 data). The loss exceeds 7% of total cigarette revenues in seven states.

In its 1977 report, *Cigarette Bootlegging: A State and Federal Responsibility*, the Commission recommended that the Congress allow state and local governments to levy excise and sales taxes on cigarettes sold at military installations. This approach is still favored by most state tax administrators for five main reasons. (1) As mentioned above, there is a substantial revenue loss. An estimated 31 percent of this loss results from resales to unauthorized personnel. (2) This exemption is a fringe benefit provided to military personnel and is financed by state and local governments. (3) Cigarettes cannot be viewed as a necessity nor as a major item of personal expense and the imposition of state and local taxes will not create a significant hardship on military personnel. (4) The federal government imposes its cigarette tax on military sales and state and local governments should be extended the same authority. (The 8-cent increase in the federal cigarette excise tax in 1983 was imposed on military sales and no strong evidence was offered that the increase imposed a significant hardship on military personnel.) (5) The extension of the cigarette tax to military bases will remove a source of cigarette tax evasion and increase revenues in several states by an amount sufficient to allow a significant reduction in the state cigarette tax rate. For example, extending state cigarette taxes to military sales would allow a 4-cent reduction in the cigarette tax in Hawaii, a 3-cent reduction in Washington and a 2 cent reduction in Florida.

The military view is that the exemption from state and local taxes is an important benefit to servicemen, helping to offset low pay and difficult working conditions. Military officials also point out that most base commanders impose restrictions on the purchase of cigarettes in an effort to reduce illegal sales. There is little reason to expect that the military sales exemption will be repealed by Congress. Therefore, the most reasonable solution appears to be close cooperation between military officials and state tax administrators in states where the military privilege is being abused.

Indian Reservations

The Commission concludes that the illegal sale of cigarettes from Indian reservations is a growing problem in a number of states, despite recent court recognition that states have the legal right to tax sales to non-Indians. The Commission, therefore, reaffirms its 1977 recommendation that state tax officials attempt to reach an agreement with Indian leaders for precollection of the cigarette tax sold on Indian reservations. The state should agree to refund the tax paid by residents of the reservations, as well as provide some compensation for revenue lost on sales to non-Indians, based on a mutually agreeable formula. The Commission also directs its staff to work with state tax officials, Indian representatives, the Department of Interior, and other interested parties to develop legislation that can be used by the states to implement these mutual agreements.

In ACIR's 1984 state survey on cigarette tax evasion, five states listed Indian reservation privilege abuses as their most serious tax evasion problem and three states listed it as their second most serious problem. The problem is most severe in the Western states of Montana, New Mexico, Arizona, and Washington, but in recent years has developed into a fairly serious problem in Florida and

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*Congressman Theodore Weiss filed the following dissent:

The Advisory Commission on Intergovernmental Relations recommendation dealing with the sale of cigarettes on military installations does not adequately address the problem—the estimated loss of $178 million a year due to the exemption of cigarettes from state and local taxes. About one-third of this total loss is due to the unauthorized sale of cigarettes to nonmilitary personnel. An even more serious problem still remaining is that the military subsidy encourages smoking, a known health hazard.

In 1976 and 1977, the ACIR adopted recommendations urging the Congress to remove the prohibition against the imposition of state and local sales and cigarette taxes on military purchases. As an irreducible minimum, the present Commission should have urged that Congress require military installations to adopt the same policy now employed by the Veterans Administration—requiring their facilities to charge the local prevailing price for cigarettes. That 1977 Veterans Administration decision resulted in a 33% decline in cigarette sales over the next two years.

The adoption of such a pricing policy by the military would eliminate cigarette tax evasion, reduce the incentive for smoking, and increase state and local tax revenues. PXs and commissaries would not lose profits as the higher price on cigarettes would more than offset the fall in sales.

This is a sensible compromise that retains the military tax exemption but eliminates most of the problems caused by this exemption. State and local governments do not gain as much revenue as would be gained by imposing their taxes on cigarette sales and the military gives up a small benefit for personnel.

Wisconsin and is spreading to other states, such as New York.

The courts have restricted the states' taxing power on Indian reservations but have ruled in recent years that the cigarette tax should be imposed on non-Indians. However, some tribes continue to sell untaxed cigarettes to non-Indians despite seizures of cigarettes outside reservations by state law enforcement officials and on-reservation seizures in two states.

Several states such as South Dakota, Wisconsin and Minnesota have addressed the problem by precollecting the tax on sales to Indian reservations and refunding the cigarette tax to the Indians on the basis of average statewide per capita consumption. A number of Indian tribes, however, have been unwilling to enter into agreements with a state because of the revenue loss to the tribe, strong feelings about Indian sovereignty, and distrust of government officials.

Short of national legislation, the only reasonable solution to the problem appears to be mutual agreements between Indian tribes and state governments. These agreements might be facilitated by a cooperative effort among the affected states to develop consistent policies and similar state legislative responses to the cigarette tax evasion problem.

FOOTNOTES

[1] "Proceedings of the Fifty-Seventh Annual Meeting," National Tobacco Tax Association, 1983, Federation of Tax Administrators, Washington, DC.

[2] See Kenneth E. Warner, "Cigarette Excise Taxation and Interstate Smuggling: An Assessment of Recent Activity," *National Tax Journal*, December 1982.

CENTER FOR SCIENCE IN THE PUBLIC INTEREST

STATEMENT OF BRUCE A. SILVERGLADE, DIRECTOR OF LEGAL AFFAIRS

PREPARED STATEMENT

Senator ABDNOR. Has Mr. Peirce come in the room yet?

Bruce Silverglade, director of the Center for Science in the Public Interest. We welcome you.

Mr. SILVERGLADE. Thank you, Mr. Chairman.

Good afternoon. My name is Bruce Silverglade. I am director of legal affairs for the Center for Science in the Public Interest. With me is Mitchell Zeller, who is a staff attorney with our office.

I request that my prepared statement be inserted in the record and this afternoon I would like to briefly summarize my remarks for you.

Senator ABDNOR. Fine. Without objection it will be made a part of the record.

[The statement follows:]

STATEMENT OF BRUCE A. SILVERGLADE

Good afternoon. My name is Bruce Silverglade. I am director of legal affairs at the Center for Science in the Public Interest (CSPI). The Center is a non-profit consumer health organization and has had a longstanding interest in improving national health policies. CSPI is supported by individual donations of our approximately 35,000 members.

Since 1972, we have worked to improve regulation of alcoholic beverage labeling and advertising. Today, I would like to address two matters of great concern to us: the first involves a final regulation rescinded by ATF that would have required ingredient labeling of alcoholic beverages. The second concerns a veto by Treasury Secretary Baker of a proposed rule governing the use of athletes and celebrities in alcoholic beverage advertising.

Ingredient Labeling

Ingredient labeling is an essential public health measure. At least one and one-half million Americans are allergic to alcoholic beverage ingredients. These persons often suffer accidental reactions to beer, wine and liquor because they cannot avoid brands which contain ingredients that cause symptoms ranging from runny nose to severe asthmatic attacks requiring hospitalization.

The Food and Drug Administration specifically stated in a memorandum to ATF that "reliance on ingredient declarations may be the only practicable means for [these] consumers to avoid the offending substances." Moreover, approximately 20 beer drinkers died from cobalt sulfate, an additive used in beer during the 1960's. Doctors treating these patients said they could have saved some lives had they been able to look at a label and find out that cobalt sulfate was in the beer consumed by these unfortunate individuals.

Ingredient labeling of alcoholic beverages has widespread public support. In a Gallup poll conducted for the National Council on Alcoholism in 1983, 61 percent of Americans stated they favor a federal regulation requiring ingredient disclosure of alcoholic beverages. In addition, the Consumer Federation of America, which represents hundreds of consumer organizations, endorsed ingredient labeling in its 1985 policy resolution statement.

This subcommittee has taken substantial interest in ATF's regulation of ingredient labeling. As you know, Mr. Chairman, ATF issued final regulations requiring ingredient disclosure in 1980, but rescinded such regulations in 1981. That action was reversed by the United States Federal District Court here in Washington in 1983. The court ordered that the regulation be reinstated no later than February 8, 1984. Notwithstanding, ATF rescinded the rule once again in October 1983. That action is now being challenged in court. We expect a decision from the court this spring or early summer.

Last time the court rendered a decision, it ordered that the Ingredient Disclosure Rule reinstated within one year. This subcommittee, however, felt that the rule should not be reinstated prior to allowing the industry and the government to make an appeal. Although this subcommittee could not have known at the time, the courts themselves were willing to take such action. In 1983, the U.S. Court of Appeals stayed the District Court's order requiring reinstatement of the regulation prior to an appeal being heard. Thus, the restriction placed in ATF's FY

1983 appropriations bill was rendered superfluous. Now that it is plainly apparent that the court of appeals was willing to stay the District Court's order requiring reinstatement, we believe that Congress no longer need be involved in this matter. The record before the courts in this case already runs thousands of pages. Only the courts have the time and resources to carefully examine this record and determine if a stay pending appeal is warranted. As I mentioned, the court of appeals in this case previously took that precise action. Thus, there is no need for Congress to maintain its involvement in this matter. We therefore urge that such language be deleted from this year's appropriations bill.

Advertising Regulation

The importance of improving alcoholic beverage advertising regulation can not be overstated.

ATF first began to explore this matter in 1978 when it issued an advance notice of proposed rulemaking. At that time, ATF sponsored research on the effects of alcoholic beverage advertising. This study, completed by Michigan State University researchers in 1981, found:

- Exposure to advertising is related to measures of excessive drinking behavior and problem drinking.
- Advertising appears to have a positive influence on drinking behavior during the adolescent years.
- Endorsements by athletes or entertainers have a major impact on young people who are impressed with these celebrities.

As a result of these findings, ATF held public hearings in 1981 and ultimately drafted a series of proposed rules to deal with such issues as subliminal advertising, therapeutic claims in advertising, and the use of athletes, celebrities, and other role models in advertising. A ban on subliminal advertising was finalized in 1984, and proposals to limit therapeutic claims are still pending. Today, we wish to focus on the remaining proposed rule which we understand would further restrict the use of athletes and celebrities in alcoholic beverage advertising, as well as the use of athletic events to promote alcoholic beverage consumption. While we are not familiar with the details of this proposal, we understand it would have prohibited the appearance of all retired as well as active professional athletes in alcoholic beverage advertising.

We enthusiastically support this measure. Sports promotion is used by the alcoholic beverage industry to improperly attract two prime targets -- young people and heavy drinkers.

Alcoholic beverage producers make no secret about promotional techniques used to attract youthful consumers. One marketing executive, quoted in the Los Angeles Times, explained why brewers sponsor sporting events. He stated, "People like to identify with sports heroes. If one is wearing your logo, they will buy your product because he does." The Michigan State University study found such techniques to be particularly effective on young people. Similarly, a Schlitz Brewery official has stated that whenever a young racing driver appeared in a Schlitz emblazoned outfit in his role as guest television commentator, the company noted a marked increase in sales.

Statements by beer industry executives and industry observers also leave no doubt that sports promotion targets heavy

drinkers. Anheuser-Busch's group marketing manager Robert McDowell wrote an article entitled, "How We Did It," for Marketing Times, where he explained the beer company's strategy for staying on top. McDowell stated, "We created a new media strategy to achieve a share of voice dominance within the industry and increased advertising expenditures four-fold, with greater orientation toward sports programming to reach the heavy beer drinker." An Anheuser-Busch marketing vice-president similarly told the Berkeley Gazette, "It was born of necessity. There was one thing we knew about the heavy drinker: he was a sports lover. That was our targeted audience."

The alcoholic beverage industry's reckless attempt to draw the young and heavy drinkers to their products prompted ATF's concern about the use of athletes and sporting events to promote alcoholic beverage consumption. To respond to this problem, ATF carefully developed a proposal to limit such promotions over a four-year period. ATF's proposed regulation was approved by Stephen Higgins, the director of ATF, John Walker, Assistant Secretary for Enforcement and Operations, as well as the General Counsel of the Treasury Department, the Executive Secretariat's office and, presumably, the Office of Management and Budget. Despite these approvals, the proposal was held up by Secretary Baker himself in March. Since the Secretary's office has refused to speak out on this matter, we can only assume that Secretary Baker has succumbed to special interest favoritism on behalf of the alcoholic beverage industry.

We urge this subcommittee to support ATF's proposal to limit the use of athletes and athletic events in alcoholic beverage marketing. There is no question that it is certainly in the public interest to at least allow the agency to solicit comments on its proposal. We therefore request that the committee direct the Department to publish ATF's proposal for comment and report back to the committee with its evaluation of the public comment and its tentative conclusions.

We would like to thank the committee for this opportunity and we would be glad to answer any questions concerning our testimony.

Mr. SILVERGLADE. The center is a nonprofit consumer health organization and has had a longstanding interest in improving national health policies. CSPI is supported by individual donations of our approximately 35,000 members.

Since 1972, we have worked to improve regulation of alcoholic beverage labeling and advertising. Today, I would like to address two matters of great concern to us. The first involves a final regulation rescinded by ATF that would have required ingredient labeling of alcoholic beverages. The second concerns a veto by Treasury Secretary Baker of a proposed rule governing the use of athletes and celebrities in alcoholic beverage advertising.

First, ingredient labeling. Ingredient labeling is an essential public health measure. At least 1½ million Americans are allergic to alcoholic beverage ingredients. These persons often suffer accidental reactions to beer, wine, and liquor because they cannot avoid brands which contain ingredients that cause symptoms ranging from runny nose to severe asthmatic attacks requiring hospitalization.

Let there be no mistake, the Food and Drug Administration specifically stated in a memorandum to ATF that reliance on ingredient declarations may be the only practical means for these consumers to avoid the offending substances.

In addition, ingredient labeling of alcoholic beverages has widespread public support. In a Gallup poll conducted for the National Council on Alcoholism in 1983, 61 percent of Americans stated they favor a Federal regulation requiring ingredient disclosure of alcoholic beverages. In addition, the Consumer Federation of America, which represents hundreds of consumer organizations, endorsed ingredient labeling in its 1985 policy resolution statement.

This subcommittee has taken substantial interest in ATF's regulation of ingredient labeling. As you know, Mr. Chairman, ATF issued final regulations requiring ingredient disclosure in 1980, but rescinded such regulations in 1981. That action was reversed by the U.S. Federal District Court here in Washington in 1983. The court ordered that the regulation be reinstated no later than February 8, 1984. Notwithstanding, ATF rescinded the rule once again in October 1983. That action is now being challenged in court by my organization. We expect a decision from the court this spring or early summer.

Last time the court rendered a decision, it ordered that the ingredient disclosure rule reinstated within 1 year. This subcommittee, however, felt that the rule should not be reinstated prior to allowing the industry and the Government an opportunity to make an appeal. Although this subcommittee could not have known at the time, the courts themselves were willing to take such action. In 1983, the U.S. Court of Appeals stayed the district court's order requiring reinstatement of the regulation prior to an appeal being heard. Thus, the restrictions placed in ATF's fiscal year 1983 appropriations bill was rendered superfluous. Now that it is plainly apparent that the court of appeals was willing to stay the district court's order requiring reinstatement, we believe that Congress

no longer need be involved in this matter. The record before the courts in this case already runs thousands of pages. Only the courts have the time and resources to carefully examine this record and determine if a stay pending appeal is warranted. As I mentioned, the court of appeals in this case previously took that precise action. Thus, there is no need for Congress to maintain its involvement in this matter. We, therefore, urge that such language be deleted from this year's appropriations bill.

Next I would like to turn to advertising regulation, although I would be pleased to answer any questions on ingredient labeling.

The importance of improving alcoholic beverage advertising regulation cannot be overstated.

ATF first began to explore this matter in 1978 when it issued an advance notice of proposed rulemaking. At that time, ATF sponsored research on the effects of alcoholic beverage advertising on alcohol abuse problems. This study, commissioned by ATF at a cost of $90,000, was finished in 1981, completed by Michigan State University researchers and found exposure to advertising is related to measures of excessive drinking behavior and problem drinking; advertising appears to have a positive influence on drinking behavior during the adolescent years; endorsements by athletes and entertainers have a major impact on young people who are impressed with these celebrities.

As a result of these findings, ATF held public hearings in 1981 and ultimately drafted a series of proposed rules to deal with the problems surfaced by the Michigan State study.

Today we wish to focus on the remaining proposed rule which we understand would further restrict the use of athletes and celebrities in alcoholic beverage advertising, as well as the use of athletic events to promote alcoholic beverage consumption. While we are not familiar with the details of this proposal, we understand it would have prohibited the appearance of all retired as well as active professional athletes in alcoholic beverage advertising.

We enthusiastically support this measure. Sports promotion is used by the alcoholic beverage industry to improperly attract two prime targets, young people and heavy drinkers.

Alcoholic beverage producers make no secret about promotional techniques used to attract youthful consumers. One marketing executive, quoted in the Los Angeles Times, explained why brewers sponsor sporting events. He stated, "People like to identify with sports heroes. If one is wearing your logo, they will buy your product because he does." The Michigan State University study found such techniques to be particularly effective on young people.

Statements by beer industry executives and industry observers also leave no doubt that sports promotion targets heavy drinkers. Anheuser-Busch's group marketing manager, Robert MacDowell wrote an article entitled, "How We Did It for Marketing Times" where he explained the beer company's strategy for staying on top. MacDowell stated, "We created a new media strategy to achieve a share of voice dominance within the industry and increased advertising expenditures

fourfold, with greater orientation toward sports programming to reach the heavy beer drinker."

The alcoholic beverage industry's reckless attempt to draw the young and heavy drinkers to their products prompted ATF's concern about the use of athletes and sporting events to promote alcoholic beverage consumption. To respond to this problem, ATF carefully developed a proposal to limit such promotions over a 4-year period. ATF's proposed regulation was approved by Steven Higgins, the Director of ATF, John Walker, Assistant Secretary of Enforcement and Operations, as well as the general counsel of the Treasury Department, the Executive Secretariat's Office and, presumably, the Office of Management and Budget. Furthermore, Carl Turner, the President's assistant for alcohol and drug abuse problems has supported the goal of this proposal.

Despite these approvals, the proposal was held up by Secretary Baker himself in March. We urge this subcommittee to support ATF's proposal to limit the use of athletes and athletic events in alcoholic beverage marketing. There is no question that it is certainly in the public interest to at least allow the agency to solicit comments on its proposal. We, therefore, request that the committee direct the Department to publish ATF's proposal for comment and report back to the committee with its evaluation of the public comment and its tentative conclusions.

We would like to thank the committee for this opportunity and we would be glad to answer any questions concerning our testimony.

Senator ABDNOR. Thank you, Mr. Silverglade.

We have been wondering too and checking and we will see what comes from it.

I will ask to move on. We have a number of witnesses and I have to get up on the floor.

We thank you and if anything comes to mind, we will feel free to submit questions to you in writing.

LOS ANGELES ALLIANCE FOR EQUITABLE CUSTOMS STAFFING

STATEMENTS OF:

SIDNEY MORSE, GENERAL PARTNER, CALIFORNIA MART

ARTHUR LITMAN, MEMBER, EXECUTIVE COMMITTEE, LOS ANGELES ALLIANCE FOR EQUITABLE CUSTOMS STAFFING

ACCOMPANIED BY MARGARET SHOSTACK, CUSTOMS ATTORNEY, KANE, SHOSTACK & TOW

Senator ABDNOR. Next witnesses are Sidney Morse and Arthur Litman.

Again, your complete statements will be made a part of the record.

Mr. LITMAN. My name is Arthur Litman and I am chairman of the Los Angeles Customs and Freight Brokers Association, and a director of the Foreign Trade Association of Southern California and a member of the executive committee of the Los Angeles Alliance for Equitable Customs Staffing. I am also president of the firm of Castelazo and Associates, a licensed customs broker located in Los Angeles.

With me is Margaret Shostack, a customs attorney with the firm of Kane, Shostack & Tow. Margaret is also a director and chairman of the customs committee of the Los Angeles Chamber of Commerce International Trade Council.

A list of our members is attached to the statement and we thank you for the opportunity to present our views today.

Senator, we have a problem in Los Angeles. Our problem is that we just do not have enough numbers of customs personnel to handle the tremendous volume of importations arriving at our ports. This causes unreasonable delays, delays in everything, in the release of cargo from the docks, from the airport, from the processing of documentation and delays in reviews of paper which must be examined before cargo can be released. There are no clerks to enter data into our terminals to aid in the examination of cargo. Inspectors must sit at terminals and input data instead of examining cargo and marking them and determining proper rates of duty.

There are not nearly enough employees to move documentation between the location of the custom house and the ports. During the peak season it takes 12 days to process. These delays cost us all and in many ways. If merchandise cannot be removed from the piers or the airport within a set amount of time, the importer will incur shortage costs. These will cause clogged ports and the importers, when their merchandise is not timely received lose money and worry that too many lost orders will cost them their business, particularly the small importers.

These delays cost our community as well. It costs us in our reputation. It causes a chilling effect on use of our area as a landing and destination. This costs in lost jobs and impedes the normal development of our international economic community.

For instance, I have a client who, to avoid delays in Los Angeles airport flies their cargo to San Francisco, clears customs there within an hour and transfers their merchandise down to Los Angeles. This gets it transferred to him the same day. Whereas, if he were to release it in Los Angeles, it would take at least 2 days. It is ridiculous that he has to incur the cost of transportation between San Francisco and Los Angeles.

Insufficient staffing has resulted in tremendous growth in the Los Angeles area of complaints. In the past decade we have had a 300-percent increase in the number of formal requests and we are ahead by 28 percent of last year. There is no increase in customs staffing and if we deduct those individuals who have been removed to handle such projects such as drug interdiction, we have fewer individuals to examine commercial operations than a decade ago.

Our community has studied this carefully and determined that we need a minimum of 150 additional personnel to bring our level of staffing to a par with other major sea ports in the United States. I draw your attention to my written comments which shows where these individuals could best be used.

Senator ABDNOR. You say 150?

Mr. LITMAN. Yes; it breaks it down between customs inspector, import specialists, and clerical support staff. It also breaks it down by location, between facility, airport, and the primary facilities at the harbor.

It is not just a question of equity. What we are asking for is effective deficit strategy. Studies have shown such an increase will pay for itself many times over in collection of increased duty, in a higher compliance standard as well as better enforcement program. We in Los Angeles are pleased that a member of your staff was able to visit us and see our situation firsthand and we look forward to you helping us in solving our problems.

I want to thank you very much.

Senator ABDNOR. Thank you.

Mr. MORSE. I am Sidney Morse and I am a general partner of the California Mart. The California Mart has 1,854 tenants who sell men's, women's, and children apparel to retail stores at wholesale.

I also represent the Los Angeles Headquarters Association, a group of community-minded business people who seek to attract and retain businesses in the greater Los Angeles area. I am chairman of their economic development committee.

There are two great problems which face us in Los Angeles. The first is the impending closure of the downtown office where four interrelated functions contained in one location will be sent to three distant areas. Thirty percent of the custom business in the greater Los Angeles area is handled in this office.

The second major problem is the consistent lack of an adequate number of customs inspectors, computer terminals, and quota clerks. These people are needed to avoid delays that our tenants, business people, and job creators who import and export apparel have been experiencing moving their merchandise through the ports of Los Angeles and Long Beach.

I want you to tell you about the apparel industry. It is seasonal and the effect by delays are tremendous. In a 90-day selling season, if goods are delayed up to 20 days, that is 22 percent of their season. Montgomery Ward experienced that and it cost them $500,000. You must understand that the threat of cancellation hangs over every importer and manufanturer's head. You have heard about delays by Sears, Penney's, and Wards. There is the Tomboy, the Campus Casuals, the Leroy Knits, small business people who can't stand to lose $500,000, let alone $100,000. They experience delays up to—from 6 to 15 days. This results in lower profits, lower taxes, and, unfortunately, increase our deficit because they are not making their share of taxes.

Customs officers are working through their lunch and overtime. The local cooperation is terrific but we need more people. It is due to an imbalanced system at customs. Los Angeles/Long Beach because of its unprecedented growth is suffering from a lack of personnel. Customs inspectors are being used to run terminals. That is clerical work and those inspectors could be used for inspection and drug enforcement if

we had additional personnel. You do not have to be reminded that lax inspection systems allow drug dealers to enter must markets.

Customs is also closing the downtown LA office. This takes its four services to three varied locations. Four hundred companies use this facility, imports, banks, factories, freight forwarders, and tourists registering their goods to take out of the country. No notice, nothing, just closing. No attention to community input.

The Los Angeles Chamber of Commerce represents thousands of members and have gone on record to keep this facility open. All falling on deaf ears. We have serious problems in Los Angeles. We need these 150 customs personnel. I fervently request and suggest you analyze the evidence and specifically earmark funds to keep our downtown office and give us our needed personnel to run an efficient office. As Thomas Jefferson said, "Institutions must keep pace with the changing times." Please do not allow our customs office in Los Angeles to be dismantled.

Thank you for the rare privilege of addressing you.

Senator ABDNOR. Thank you, Mr. Morse and Mr. Litman. We are aware of the problem. You mentioned, Mr. Litman our staff was out there. Solutions, I don't know how easy they come, particularly when we are looking at our budget and adding 150 people. We will look at it in the Budget Committee. We have tried to work with customs in every way and we have been staunch supporters of our law enforcement agencies. We have done so over the years and it is getting more difficult. We will do everything we can and certainly give you consideration.

Thank you very much.

I am going to take a brief recess while I take care of some business here.

[A brief recess was taken.]

PREPARED STATEMENTS

Senator ABDNOR. The committee will be in order.

At this time I will ask unanimous consent to include in the record a statement by Ray Remy, president of the Los Angeles Chamber of Commerce, immediately followed by Mr. Morse's presentation.

[The statements follow:]

STATEMENT OF RAY REMY, PRESIDENT, LOS ANGELES CHAMBER OF COMMERCE

Mr. Chairman, my name is Ray Remy. I am president of the Los Agneles area Chamber of Commerce and am here today representing the approximately 3,500 member companies of our organization. We appreciate the opportunity of calling to your attention the very difficult and critical situation which exists within our Los Angeles/Long Beach customs district.

Through consulates and trade offices, 70 foreign countries and six other governments are now represented in the Los Angeles area. The Los Angeles/Long Beach maritime industry, with related and supporting activities, supports 68,000 jobs, $1.6 billion in earnings and $4.5 billion in gross sales. It provides $220 million in State and local taxes. Last year, the chamber estimates 300,000 jobs resulted from international trade in the five-county area. Many affiliated jobs are created by the local trade activities. Customs collections for 1984, as reported in the publication Customs USA, for the Los Angeles district were $2.1 billion, a growth of 91 percent since 1980.

Our situation is not a new one. It is a cumulative problem which arises as a result of sustained growth in our international trade at a rate above the national average. For many years, international trade through our district has accelerated at the rate of 25 to 30 percent per year while the national average has been 4 percent. Customs District 27, comprising the Ports of Los Angeles and Long Beach and Los Angeles International Airport, has long been grossly understaffed to handle our continually increasing volume of trade.

Efforts to have the customs region or customs headquarters assign adequate personnel to our area have been unsuccessful. In a prior meeting, representatives of the Los Angeles area Chamber of Commerce, the Foreign Trade Association of Southern California and the Ports of Los Angeles and Long Beach, were advised that customs headquarters does not recognize that our area has a more critical need than other districts. They have continued to refuse to make any additional allotment of personnel to handle the increasing workload.

In the past fiscal year alone customs entries in the Los Angeles district have increased by 24 percent—and customs collections by 42 percent. And we continue to operate not only without additional customs personnel, but, in fact, with reductions of personnel and threat of closing a facility which generates 30 percent of the business of the district—the downtown Los Angeles customshouse. We hear the complaints from the importing community, and they center around delays in clearing import cargo, both quota and nonquota goods. These delays are caused primarily by an insufficient number of cargo inspectors, qualified import specialists, and entry processing personnel.

Mr. Chairman, we believe that the Los Angeles customs district director and staff have made every possible effort to meet the increasing demand for service, but they simply do not have enough personnel to do the job. We believe that nearly 150 additional positions are needed immediately to meet the current demand in the district: 63 inspectors; 29 quota and operations clerks; 21 input clersk (ACCEPT); 35 commodity specialists; and 1 cashier.

Earlier I referred to the closing of a facility which generates 30 percent of the district's business—the downtown customshouse. Many industries, including the wearing apparel, textile, and furniture industries are concentrated in the central area. Yet the staff in this office has been repeatedly reduced during the past year or two to a state where meaningful and reasonable service is no longer available.

Mr. Chairman, we would like to see the Congress direct the U.S. Customs Service to increase the personnel and services in all commercially oriented jobs to bring the Los Angeles area district up to an equitable balance with the other cutoms districts in the country. We would also like to see an annual system of review set up to provide pro rata increases of personnel directly related to future growth in the volume of commercial trade.

Thank you for the opportunity to appear at today's hearing and bring to your attention our critical situation.

STATEMENT OF SIDNEY MORSE

Good afternoon Senators and staff. I am Sidney Morse, a general partner of the California Mart located in downtown Los Angeles.

The California Mart has 1,854 tenants who sell mens, womens, and childrens apparel at wholesale to retail stores. I also represent the Los Angeles Headquarters City Association, a group of community minded business people who seek to attract and retain businesses in the greater Los Angeles area. I am the chairman of their committee for economic development.

There are two great problems which face us with respect to the U.S. Customs Office.

The first is the impending closure of the downtown office of U.S. Customs where four interrelated functions contained in this one location will be transferred to three different and distant locations.

The second major problem is the consistent lack of an adequate number of customs inspectors, computer terminal operators, and quota clerks. These personnel are needed to avoid the delays that our tenants, Los Angeles business people, and job creators who import and export apparel, have been experiencing moving their merchandise through the Ports of Los Angeles and Long beach.

Delays ranging up to 20 days in order to process merchandise through customs have been reported. These problems are indigenous to apparel and textiles only as these items are under quota and the personnel necessary to process these products have a backlog of work that causes these delays. I would like to emphatically state that this is due to lack of personnel only. I would welcome you to elicit remarks from those people who are actually on the job who have told me how it can be improved. I have been to the Customs Office at the port and have talked to the inspectors. They work through their lunch and work overtime. The simple fact is that they need more help. I have submitted to you copies of letters from my tenants and other business people who are unhappy with the current service rendered by the Customs Department.

Los Angeles/Long Beach is the largest entrance port for imports in the United States. It will continue to grow at the same dramatic acceleration as it has in the past. It makes sense to me as a businessman to provide the additional personnel necessary to process merchandise as the Customs Office is a profit center for the Government. Any delays are passed on as decreased profits, and, therefore, less taxes are the result.

The apparel industry is a seasonal industry and if a manufacturer loses 20 days of a 90-day selling season, he is losing 22 percent of the time that the products could be on the shelf in a store available for sale.

I implore you to recognize these problems and alleviate the current situation by allocating more funds for the approximately 150 people needed at the airports and seaports. In addition I would like to point out that 30 percent of the import paperwork is done in the downtown location currently about to be closed. We of the downtown community desire the retention of a downtown office in order to continue the cashiering, documentation, inspection, and ACCEPT processes.

Over 400 companies, which include textile wearing apparel importers, international banks, factors, general importers, foreign freight forwarders, steamship/truckers use this facility. Plus tourists obtain passports and register foreign made items to go out of and return to America in this office.

I would like to point out that the Central City Association, in addition to the Los Angeles Chamber of Commerce, and the Los Angeles Headquarters City Association, representing thousands of members, have filed letters to continue a U.S. customs presence in the downtown area.

I urge you to allocate funds specifically for the additional 150 people, and the retention of a downtown office for U.S. Customs. I would also request that these funds be specifically earmarked for those purposes in order that we ensure that your request will be carried out.

Thank you for the rare privilege of addressing you.

LETTER FROM SIDNEY MORSE

APRIL 20, 1985.

To whom it may concern:

The California Mart is proud to offer the U.S. Government's Customs Service a mutually agreeable space, free of charge, for its downtown facility.

Very truly yours,

SIDNEY MORSE,
General partner, California Mart.

ATTACHMENT A

FEBRUARY 14, 1985

ESTIMATE OF ADDITIONAL PERSONNEL NEEDS—LOS ANGELES/LONG BEACH (COMMERCIAL OPERATIONS)

	Seaport	Airport	Downtown Los Angeles
Inspectors	35	25	3
Quota and operations clerks	15	10	4
Input clerks (ACCEPT)	18	0	3
Commodity specialists	25	6	4
Cashier	0	0	1
Total	93	41	15
Total personnel urgently needed in Los Angeles/Long Beach district for commercial operations		149	

LETTER FROM SIDNEY MORSE

APRIL 20, 1985

The board of directors of the Los Angeles Headquarters City Association has voted unanimously to express strong concerns for the expeditious movement of foreign freight through the Ports of Los Angeles and Long Beach, and for the retention of a downtown Los Angeles Customs Office.

We think it is important for the U.S. Customs Service at the Ports of Los Angeles and Long Beach to have additional funds for more clerical personnel to relieve the bottleneck created by the extra processing necessitated by quotas.

Los Angeles/Long Beach is the largest entrance port for imports in the United States. It is imperative that they be given the additional personnel necessary to process merchandise as the Customs Office is a profit center for the Government. Any delays are passed on as decreased profits, and, therefore, less taxes are the result.

Over 30 percent of the import paperwork is done in the downtown office currently about to be closed. We of the downtown community desire the retention of this office in order to continue the four interrelated functions contained in this one location which will be transferred to three different and distant locations.

We implore you to recognize these problems and alleviate the current situation by allocating more funds for the approximately 150 people needed at the airports and seaports, and to retain a presence in downtown Los Angeles.

SIDNEY MORSE,
Chairman, Economic Development Committee.

LETTER FROM RODNEY N. ROOD, CHAIRMAN, CENTRAL CITY ASSOCIATION OF LOS ANGELES

JANUARY 31, 1985

MS. ALICE RIGDON,
District Director, U.S. Customs, 300 South Feery St., Terminal Island, CA

DEAR MS. RIGDON: The Central City Association is a nonprofit organization designed to promote a prosperous economic, business, cultural, and residential environment in downtown Los Angeles.

On behalf of our 230 members, we urge you to maintain a satellite office of the U.S. Customs Department in downtown Los Angeles. We hope that you will either reconsider abandoning your existing office in the World Trade Center or consider moving to another centrally located office near your existing location.

As the second largest financial center in the Nation, and as the leading gateway to

the burgeoning trade with the Pacific Rim, we feel that it is essential for a customs office to be located in downtown Los Angeles.

If we can assist you in any way to encourage you and your office to reconsider your decision to move out of downtown, please feel free to call upon us.

Sincerely,

RODNEY W. ROOD,
Chairman.

LETTER FROM RAY MALLEL, VICE PRESIDENT, LOUBELLA EXTENDABLES, INC.

APRIL 18, 1985

SID MORSE,
California Apparel Mart, Suite A727, 110 East Ninth St., Los Angeles, CA

DEAR MR. MORSE: Thank you for your concern with respect to the delay of clearing merchandise at the Los Angeles port.

As you know in apparel business we have short selling seasons and we have had delays up to 10–15 days caused by lack of inspection personnel and computer operators.

It seems to us that other ports get things through faster and we think we ought to have more personnel here in Los Angeles because of the greater volume.

Very truly yours,

RAY MALLEL,
Vice president.

LETTER FROM STEVEN C. GORDON, PRESIDENT, DOMINO OF CALIFORNIA, INC.

APRIL 19, 1985.

Mr. SID MORSE,
California Mart, 110 East Ninth St., Suite A727, Los Angeles, CA

DEAR SID: First, I'd like to say thank you for taking up this matter on our behalf, as well as many others, in Washington DC.

The purpose of this letter is to expres our views and experience with the U.S. Custom Service at Los Angeles Harbor. Before the implementation of the ACCEPT system, a quota entry could be cleared and released at an average of 3 to 6 working days; however, presently, it takes an average of 6 to 10 working days from the date of filing.

Five year ago, if a quota was not released by the quota desk after 3 working days from the date of filing, an official request to search the missing entry could be made, but, now, this request cannot be made until it has passed 5 working days. The reasons given for the extended period (2 days) are: (1) a cut in the budget, and (2) they're short of personnel.

Prior to the establishment of this ACCEPT system, it would take approximately 1 working day to get an entry signed and released by the inspection unit; and, if an entry was misplaced or lost, a search could be made at the importer's expense by sending a person to the harbor to physically search the place. With the present ACCEPT system in effect, it does not allow for a search to be made, and it is taking a minimum of 2 to 3 working days to get an entry signed and released. In other words, once an entry goes into the ACCEPT site, it would be impossible for an importer to know when that entry could be released—until it is entered into the steamship company's computer by the custom's inspector.

To our understanding the establishment of ACCEPT system was supposedly to improve efficiency and service to the import community via a fewer number of employees; thus far, this program has only achieved advers results.

It is also to our understanding that the Port of New York does not have as large a volume of entries as does the Port of Los Angeles, yet it has substantially more inspectors than Los Angeles.

In conclusion, we would like to urge you to increase the staff in the Los Angeles district to handle the increased volume and maintain your usual reasonable service to the importers, such as ourselves.

Sincerely,

STEVEN C. GORDON,
President, Domino of California, Inc.

LETTER FROM H.R. LESKOWITZ, VICE PRESIDENT, LEROY KNITTED SPORTSWEAR, INC.

APRIL 18, 1985.

Mr. SID MORSE,
California Mart, 110 East Ninth St., Los Angeles, CA

DEAR MR. MORSE: We are by no means a large importer, however, clearing customs has become a monumental burden, bordering on a nightmare for us and other apparel importers doing business out of the Port of Los Angeles/Long Beach.

We could cite every delay we have experienced in the months since ACCEPT has been placed but each firm has its own cache of horror stories. To summarize: delays of 10 to 15 working days are not unusual, and besides demurrage and lost sales, layoffs have resulted.

Delays, we believe, are mainly in the customshouse. Insufficent clerical and commodity specialist personnel seem to fly in the face of logic in one of the largest customs revenue ports in the Nation, collecting 17 percent of all customs revenue ($2.1 billion) with only 554 in staff, which is only 4 percent of the customs staff nationwide.

We urge the hiring, as an emergency measure, immediately of at least 150 additional customs personnel for the commercial sector to ease the present situation with a review of hiring needs every year.

Sincerely,

H.R. LESKOWITZ,
Vice president, LeRoy Knitted Sportswear, Inc.

LETTER FROM MAURICE BRETZFIELD, PRESIDENT, INTERNATIONALE SET, INC.

APRIL 18, 1985.

Mr. SID MORSE,
110 East Ninth St., Room A727, Los Angeles, CA

DEAR SID: Thanks for your phone call regarding your appearance before the Senate subcommittee regarding customs delays at Port of Los Angeles/Long Beach. If nothing else I'm happy to vent my frustrations.

Although customs clearance from the Port of Los Angeles/Long Beach has always been subject to some delays the serious problems really began in November 1984. Since that time it has taken us as much as 3 weeks after the date of arrival to clear merchandise for what alway seems to be undefinable delays. I will describe for you the saga of one shipment: On February 10, 1985, two containers of T-shirts arrived at the Port of Los Angeles/Long Beach aboard the Orient Overseas Container Lines *Educator*. The documents covering this shipment were submitted in the normal manner by our customs broker to the customs authority on February 11. Due to an error on the part of customs in the interpretation of new regulations stipulating new requirements for entry numbers the documents were rejected and subsequently resubmitted on February 15. On February 18 our customs broker informed us that customs had lost our documents in their system and could not locate them (a common occurrance). In order to prove that the entry had indeed been submitted our broker had to provide customs with copies of the documents as well as a copy of a canceled check which had paid duty on the merchandise. It took us until February 26 to be able to present the check to customs. It was now February 26, 16 days after duties were paid. On that same date the shipment was rejected for clearance at the ACCEPT site being held for a possible team examination. Finally, on February 28, we received word the team opened one of the containers in question and found that the merchandise they were to examine was loaded into the front of the container, realized they would have to unload the entire

container to check the merchandise, suspended the team examination, and released the goods to us. For your information, I have enclosed all the pertinent documents relating to the above matter.

I might add that this merchandise totaling $223,024.20 f.o.b. value and bearing a customs duty in the aggregate amount of $20,415.49 was all delivered late by us to our customers as all of the merchandise in question was spring merchandise bearing February 28 completion dates.

The situation at the Port of Los Angeles/Long Beach is a complete mess creating intolerable, unjustifiable, and unfair delays in the clearance of merchandise. We are told that the situation is the result of an overburdened and short handed customs work force at the port.

I want to express my personal gratitude for taking your valuable time to help to the best of your abilities to rectify this situation.

Very truly yours,

MAURICE BRETZFIELD,
President.

LETTER FROM RICHARD G. REINIS, REINIS & BLUM

APRIL 19, 1985.

Mr. SIDNEY MORSE,
California Mart, 110 East Ninth St., Suite A727, Los Angeles, CA
Re customs problems

DEAR SYDNEY: This firm represents over 300 clients in the apparel industry in southern California, and other clients from around the United States in the same industry. Pursuant to a request from you, I made a brief survey of only a handful of clients who are importing and bringing goods through customs in the Los Angeles area.

Without exception, my clients have experienced delays. There is a noticeable difference in clearance time today, as compared to a year ago. In addition, they are aware of claims made by customs that delays are due in part to customs brokers, but each client categorically places the blame on a shortage of personnel at U.S. Customs. I have discussed this matter with Podell Industries, Inc., Warehouse Shipping and Receiving, Peyk International, Inc., and Triangle Inc.

If I can be of further assistance in gathering information for you, please call.

Very truly yours,

RICHARD G. REINIS.

LETTER FROM LEONARD EPSTEIN, PRESIDENT, CAMPUS CASUALS OF CALIFORNIA

APRIL 18, 1985.

Mr. SIDNEY MORSE,
California Mart, Room A-727, 110 East Ninth St., Los Angeles, CA

DEAR SID: Thank you for your interest in the problem we are experiencing with clearance at the Los Angeles Harbor.

Our company is located in the downtown area of Los Angeles and has been importing wearing apparel for the last 25 years.

We depend on a reasonable timeframe for the custom clearance in order to fulfill our commitments to our customers.

During the last year, the processing of textile apparel entries at the seaport of Los Angeles/Long Beach has been unreasonably slow as well as unpredictable.

The remarkable increase of textile imports at the local ports has strained the local customs resources. The handling of textile entries is subject to special scrutiny and procedures partially with the help of automated data processing systems for quota input and cargo release.

Such equipment is apparently not sufficiently staffed with capable operators: Inspectors are often used, thus taking them away from their regular duties of cargo examination.

Another negative factor is added by the fact that the downtown Los Angeles customs facility is scheduled to be closed. We need more service, not less.

Very truly yours,

LEONARD EPSTEIN,
President.

LETTER FROM JACK E. LITT, PRESIDENT, YOUNG EDWARDIAN CORP.

APRIL 17, 1985.

Mr. SIDNEY MORSE,
President, California Mart, 110 East Ninth St., Suite A727, Los Angeles, CA

DEAR MR. MORSE: You have asked me to briefly describe what delays through customs Young Edwardian has recently experienced. Last year with the institution of a new inspection and approval process, we received fabric shipped from Korea 10 days after the ship carrying the fabric arrived in port.

After several conversations with our importer and customs officials we learned that under new customs procedures each container, and, therefore, each bolt of fabric, aboard the ship had to be inspected before being released. This process and, therefore, the 10-day delay cost Young Edwardian almost $500,000 in lost business due to our own inability to meet our customer deadlines.

This incident is not an isolated one, not only for Young Edwardian, but for many other manufacturers. A thorough examination of customs procedures is absolutely in order.

Sincerely,

JACK E. LITT,
President.

STATEMENT OF ARTHUR LITMAN

Mr. Chairman and members of the committee, my name is Arthur Litman and I am chairman of the Los Angeles Customs and Freight Brokers Association, a director of the Foreign Trade Association of Southern California and a member of the executive committee of the Los Angeles Alliance for Equitable Customs Staffing. I am president of Castelazo & Associates, a licensed customs broker located in Los Angeles. A list of the members of the alliance is attached to our testimony packet. Thank you for allowing our alliance an opportunity to present our views today.

During the past decade it has been our pleasure to watch the volume of import traffic through the Los Angeles/Long Beach customs district increase steadily and at a faster pace than other ports in the country. Formal customs entries through our ports have increased 172 percent and customs collections are up 322 percent.

The Ports of Long Beach and Los Angeles have been experiencing phenomenal growth in cargo volume just as Pacific trade has taken a lead over Atlantic trade for the United States in the last year. Yet as we plan to continue to keep pace with this growth we have been extremely concerned that the U.S. Customs Service has failed to recognize or meet the current needs of our ports.

During this same decade it has troubled us to watch the Los Angeles customs' staff decrease in size in many areas. The number of inspectors, commodity specialists and clerical support personnel has declined during the period when the increases in volume were greatest.

In the past 5 years alone, formal entries filed at Los Angeles/Long Beach have increased 66 percent and collections have increased 101 percent with no corresponding increase in staff. Los Angeles is already processing more formal entries with more duties per inspector and commodity specialist than any other major seaport in the United States. In the first quarter of this year the import activity has already increased 28 percent, but instead of more help to deal with the workload, local customs is faced with yet another reduction in force. Of further concern is the fact that the first quarter of the year is usually one of the slower quarters—it would appear that 1985 will be another record year.

As you may know, total U.S. customs collections for fiscal 1984 equaled $12.5 billion. Of that, the Los Angeles customs district was responsible for collecting $2.1 billion or 17 percent of the total. Yet, the Los Angeles district presently has a staff of 554, equaling just 4 percent of the service's average positions.

In the last year our ports have logged more complaints from the trading community than ever before. The complaints concern delays in clearing cargo, both quota and nonquota goods. We concur with industry experts who indicate that these delays are primarily caused by an insufficient number of cargo inspectors, qualified import specialists, and customs clerical support. This statement is not new. We have for many years noted that the U.S. Customs Service has not remedied this situation.

We have informed customs headquarters many times of the staffing shortage in Los Angeles. We have provided statistics which show that Los Angeles has consistently received less staffing support from headquarters than other ports in the United States. We have yet to see any corrective action.

We believe that the Los Angeles district director of customs has made every effort possible to meet the increasing demand for service. We do not blame the individual customs inspectors for these delays. The inspectors we have in the Los Angeles district are some of the best in the service. Their productivity is the highest in the system. There simply are not enough of them to meet the increasing volume challenging them now.

We believe that more staff is needed in the Los Angeles district to speed clearance of entries, quota clearances, and cargo inspections. We believe that 150 additional positions are required to meet the present traffic demand in the district. (Please see attachment F)

The increase in our traffic flow, plus the added factor of additional quota restrictions this year, will add up to new levels of workload demand and, therefore, any use of historic measures of staffing in the district must take this into account when the Customs Service evaluates its staffing levels.

Congress has established new levels of import quota restrictions and we expect a 400-percent increase in items requiring quota clearance through the port this year. The clearance of quota goods through the local district office takes substantially longer than the clearance and release on nonquota goods. Our present time to clear many nonquota items through the Ports of Los Angeles and Long Beach has eroded to 5 to 7 days, and on the quota items, it can take as much as from 7 to 15 days. This is a dramatic increase over previous years and a direct result of the reduction of customs clearance personnel which has been documented to have taken place in the Los Angeles district.

The Los Angeles area is also a leader in high-tech exports and the Customs Service has increasing operation Exodus responsibilities here as well.

Our cargo projections indicate a doubling in import and export tonnage in the next 10 years: The U.S. Customs Service is approaching the future properly through the study and inauguration of computerized programs such as automated clearance system [ACS] and automated broker interface [ABI]. The alliance applauds customs' progressive thinking in this area and will support the Customs Service wherever possible to implement these systems. However, the computerized structure of tomorrow is not helping to meet the current traffic flow demands of today. We do not want to see our present shippers divert their cargo elsewhere and thereby lose the transportation efficiencies they have developed over the past years.

We urge your subcommittee to increase authorization levels and thereby increase the number of customs personnel in all commercially oriented jobs (inspectors, import specialists, and clerical functions) to ensure sufficient staff to meet the present volume of cargo flow through the Los Angeles/Long Beach customs district.

We also believe it necessary to establish an annual system of review which would more equitably allocate resources to respond to growth in the volume of commercial trade.

Please let me direct your attention to my written comments which also incorporate the specific concerns of three major retailers that utilize our ports—Sears, J.C. Penney, and Montgomery Ward.

44-565 0-85-26

Thank you.

ATTACHMENTS

A. Statement: Statement prepared by Mr. Subash Agarwal, director of customs, Sears merchandise group for presentation at February 14, 1985, field inspection in Los Angeles conducted by Congressman Edward R. Roybal. Subash Agarwal, director—customs, Sears, Roebuck and Co., Sears Tower, Chicago, IL.

B. Statement: Statement prepared by Mr. Leo F. McKenna, director of transportation, Montgomery Ward for presentation at February 14, 1985, field inspection in Los Angeles conducted by Congressman Edward R. Roybal. Leo F. McKenna, director of transportation, Montgomery Ward, Montgomery Ward Plaza, Chciago, IL.

C. Statement: Statement prepared by Mr. Steven Goldberg, regional attorney, J.C. Penney Co., for presentation at February 14, 1985, field inspection in Los Angeles conducted by Congressman Edward R. Roybal. Steven Goldberg, attorney, J.C. Penney Co., Inc., 6131 Orangethorpe Ave., Buena Park, CA.

D. Port of Long Beach inbound cargo report (and forecast).

E. U.S. Customs Service regional staffing and Los Angeles district percentage.

F. Estimate of additional U.S. Customs personnel needs—Los Angeles/Long Beach commercial operations.

ATTACHMENT A

STATEMENT OF SUBASH AGARWAL

We welcome this opportunity to provide some input on the concerns Sears, along with other affected parties in the community have regarding the efficient and timely movement of cargo at the Ports of Long Beach/Los Angeles.

We must commend the service in its aggressive commitment of resources to solving the many operational bottlenecks the public and service face day to day, by implementation of the ACCEPT and ABI and myriad of other programs. We agree with this approach, as it not only addresses resource constraints, but also the swift and prompt movement of cargo within the parameters established by U.S. customs.

Within this overall scheme we do however find certain inconsistencies in the timeliness of cargo clearance between various U.S. Customs ports. For example, our experience indicates that it takes anywhere from 2 to 20 days to clear cargo at Los Angeles with an average of 7 to 10 working days, compared to an average of 1 to 2 working days at the Ports of New Orleans, Philadelphia, and Boston. The significance here is not so much on the numbers but the tremendous disparities between ports. Specific facts and figures will be supplied upon request.

As importers who work directly with the staff of U.S. Customs at Los Angeles, and also through our brokers, A.J. Fritz & Co., we find a strong level of commitment by U.S. customs personnel at this port.

To understand, therefore, the reasons for such delays, we raise the following questions:

(1) Is the allocation of customs resources, Los Angeles versus other ports of similar volume, equitable?

(2) Is there any significant degree of difference between the mix of cargo, Los Angeles versus other ports of similar volume?

(3) Is there a logistical problem in moving documents from one point to another to obtain final release of cargo in a manner consistent with such other ports?

We endorse the facts and figures being provided here today by the officials of the Port of Long Beach, the brokerage community and others, to shed light on some of the issues raised above.

It is our fervent hope that the service recognizes this tremendous cost burden on the importing community at Los Angeles, and addresses it in a manner consistent with the levels of operation at other similar U.S. ports.

We would be more than happy to work with you directly, and through our brokers, to help improve upon this situation.

ATTACHMENT B

STATEMENT OF LEO F. MCKENNA

I am Leo F. McKenna, director of transportation for Montgomery Ward, the sixth largest retail chain, with annual sales of $6.5 billion. I am responsible for both domestic and international transportation operations. I have been involved in transportation for 27 years.

Prior to 1983 our company imports were less than 4 percent of our merchandise purchases. This volume was basically handled through the Ports of Oakland, New York, and Baltimore. Consolidations and closings of distribution facilities together with a major change in the handling of imports required the relocation of this activity. In addition to these major changes our import volume increased to a 15-percent level of purchases.

The decision to move the far east port-of-entry from Oakland to Los Angeles/Long Beach was based on economics, service, and merchandise consumption of product in the Los Angeles market.

1. The combination of international with domestic products provides a reduced inland cost to move merchandise to our 18 major distribution centers throughout the United States. (200 million pounds in 1984).

2. Ocean service to Los Angeles from Hong Kong, Korea, Japan, and Taiwan is excellent. Inland frequency to our 18 distribution points is greatly improved by the domestic-international combination.

3. Fifteen percent of our retail volume is consumed in Los Angeles, San Diego, and Phoenix. (36 of the 300 company stores).

All of the systems and operations set to handle 8,000 containers annually, have worked well. However, our biggest disappointment was the increase in port clearance time—6 days for nonquota and 12 days for quota.

The extended port clearance tends not only cause port congestion (up to 175 containers in Los Angeles/Long Beach terminals), but merchandise delays, and totally unacceptable pier detention ($550,000 in 1984).

The ocean carriers and ports responded to our needs, but customs clearance delays continue! With a continued strong dollar our volume of import shipments will remain high. We need to improve customs clearance times. Although Long Beach/Los Angeles are still our first choice, we are now conducting a study to determine the economic feasibility of moving to other port facilities.

We need more customs inspectors or a major productivity improvement.

Listed below are three examples of the type of delays we have encountered.

1. LEXA MAERSK, container #XTRU 4914779, entry submitted 2/1/85, DAD received 2/12/85, (Customs requested sample), 11 days.

2. Ever Laurel, container #EISU, 103467, entry submitted 1/28/85, DAD received 2/12/85, (Customs requested sample), 14 days.

3. Mossel Express, container #TOLU 2204392, entry submitted 2/4/85, DAD received 2/12/85, 8 days.

Here are some problems in the Los Angeles customs district that have been identified by our international transportation manager.

1. *Quota goods.*—Only four clerks on the quota desk. This contributed to clearance delays up to 2 weeks, as well as an excessive container demurrage.

2. *Delivery authorizations.*—(DAD) a major time lapse between the ACCEPT site and the pier.

3. *Errors.*—Entries that require resubmission get lost in the system. This happens frequently. The system is not able to cope with exceptions.

4. *Location of inspectors.*—Consignee should know when the inspector is available to allow pick up and release in presence of an inspector, if necessary. Need location of exam sites.

In conclusion, we believe the root of many problems and delays is a shortage of qualified staff in the Los Angeles customs district.

Montgomery Ward has made a commitment to Long Beach/Los Angeles. We support an effort to improve port clearance times. These improvements are critical as 80 percent of our imports now move through the Los Angeles port-of-entry.

We are anxious to know what steps will be taken to address our concern.
Thank you.

ATTACHMENT C

STATEMENT OF J.C. PENNEY CO.

Congressman Roybal, Congressman Anderson and quests, I'm Steve Goldberg, attorney for J.C. Penney Co. With me today are C.T. Liang, our international buying coordinator and Rick Rocco, who works for our broker F.W. Myers.

J.C. Penney Co., has experienced a good working relationship with U.S. customs over many years. We have business with virtually every major port in the United States. The custom's personnel of the Port of Los Angeles have made genuine and sincere efforts to timely process shipments for entry and release from customs custody. Nevertheless, there have been major delays in releasing our merchandise from customs.

The great increase in import traffic entering the Port of Los Angeles in the last few years coupled with recent regulatory controls and the loss of many experienced customs personnel, without adequate replacements, and no actual increases in personnel, have created a crises situation for importers of foreign merchandise.

The standard for U.S. customs to process a quota entry should be about 6 hours.

In reality all the other ports throughout the Nation—and J.C. Penney transacts business with virtually all of them—process quota entries within 2 to 3 days.

Out greatest concern with the Port of Los Angeles is the massive time delays that we are experiencing in the processing of quota entries. The average processing for J.C. Penney quota entries in Los Angeles in January was 9 days. Some of these entries took 12 days from the date of submission to the date of clearance on the delivery authorization document. Additional delays of 6 to 7 days are experienced in quota entries involving an initial reject.

Let me give you an example of a recent problem we encountered. A quota entry submitted on December 31, 1984, was rejected on January 6, 1985. It was resubmitted on January 7, 1985, and apparently the entry was lost. A duplicate entry was submitted on January 15, 1985, and was finally cleared on January 22, 1985—25 days from the date the merchandise arrived in the port.

There are two major factors which contribute to the delay problem: 1. The shortage of customs personnel to timely and properly process documentation. 2. The quota procedure involving the processing of the entry through several different departments: Quota desk, C.S.T., operations for computer input, cashier, brokers box, and finally to the ACCEPT site.

What do these delays mean to J.C. Penney?

1. Additional outright costs in the form of unnecessary demmurage.

2. Cancellatin of orders and loss of sales and unavailability of advertised merchandise. Virtually all of our imported merchandise is seasonal apparel. There are 90 days in each season. If we lose 20 days because of customs delays, we have lost over one-fifth of the season.

3. Additional costs of freight and warehouse handling on merchandise returned by the store to buyer because of untimely receipt as a result of customs clearance delays.

4. Finally, goods not received in time for the season are heavily marked down and sent back to the store as closeout merchandise.

We want to continue doing business with the Port of Los Angeles and we realize that the personnel are doing the best they can under difficult circumstances. We are asking that this crises situation at this port's custom's operations be resolved as quickly as possible by the Federal Government so that we can continue to do business here in a better and more efficient manner.

Thank you.

ATTACHMENT D

PORT OF LONG BEACH INBOUND CARGO, 1980–90

	Total inbound[1]	Total general cargo (inbound)
1979–80	[2]23,781,673 [MRT]	7,659,552 [MRT]
1980–81	24,532,875 [MRT]	8,754,955 [MRT]
1981–82	28,484,304 [MRT]	10,676,996 [MRT]
1982–83	28,034,225 [MRT]	11,018,954 [MRT]
1983–84	33,230,169 [MRT]	15,825,359 [MRT]
Est. 1984–85	34.3–35.5	16.4–17.7
Est. 1985–86	36.6–37.7	18.2–19.5
Est. 1986–87	38.8–39.9	20.1–21.4
Est. 1987–88	41.1–42.2	21.9–23.3
Est. 1988–89	43.3–44.4	23.8–25.1
Est. 1989–90	45.5–46.7	25.7–27.0

[1]Includes bulk, break bulk, liquid bulk, and general/containerized cargo.
[2]MRT = metric revenue ton—normally 2,204.6 pounds or one cubic meter, whichever provides the greater number in each shipment.

ATTACHMENT E

U.S. CUSTOMS SERVICE REGIONAL STAFFING (CURRENT, JANUARY 1985), PACIFIC REGION

District	No. inspectors	No. import specialist	No. other staff	Total
Seattle	162	35	108	305
Portland	29	10	24	63
San Francisco	150	42	159	351
Los Angeles	295	94	165	554
San Diego	248	13	59	320
Honolulu	101	8	57	166
Other areas				
Total	1,015	202	1,181	2,398
Los Angeles percent of region staffing	29	46	14	23

ATTACHMENT F

THE LOS ANGELES ALLIANCE FOR EQUITABLE CUSTOMS STAFFING

ESTIMATE OF ADDITIONAL PERSONNEL NEEDS—LOS ANGELES/LONG BEACH (COMMERCIAL OPERATIONS)

	Seaport	Airport	Downtown Los Angeles
Inspectors	35	25	3
Quota and operations clerks	16	10	4
Input clerks (ACCEPT)	18	0	3
Commodity specialists	25	6	4
Cashier	0	0	1
Total	94	41	15
Total personnel urgently needed in Los Angeles/Long Beach district for commercial operations		150	

AIR TRANSPORT ASSOCIATION OF AMERICA

STATEMENT OF JAMES E. LANDRY, SENIOR VICE PRESIDENT

Senator ABDNOR. Our next witness is James Landry of the Air Transport Association of America.

Mr. LANDRY. Thank you, Mr. Chairman.

My name is James E. Landry. I am the senior vice president and general counsel for the Air Transport Association of America, which represents most of the scheduled airlines of the United States. Seventeen of our member airlines provide regularly scheduled air service between the United States and more than 70 countries.

We appreciate this opportunity to offer several observations for the consideration of the subcommittee with respect to the fiscal year 1986 appropriations for the U.S. Customs Service.

In our prepared statement, which we request be included in the record, we offer three general comments with regard to current customs operations.

First, the airlines commend the U.S. Customs Service for implementing the dual passenger channel inspection system, commonly referred to as the red door/green door procedure, at a number of U.S. gateway airports last year. The airlines now ask that this tried and proven procedure be extended to all other U.S. gateway airports.

Second, in order to cope with the international passenger traffic at Miami and Kennedy International Airports, Eastern Airlines should be permitted to construct customs inspection facilities in its terminals at those two airports. These multimillion dollar customs facilities will be built by Eastern at no cost to the Government and in accordance with the exact specifications and dictates of the Customs Service. Northwest Airlines should also be permitted to construct similar customs facilities in its satellite terminal at New York's Kennedy International Airport.

Third, the airlines continue to be concerned over the requirement to reimburse the Customs Service for services performed outside of regular tours of duty, during week days, including Saturdays, and between 5 p.m. and 9 a.m. on Sundays and holidays. This practice compels airlines to pay customs employees over $10 million each year to perform duties and functions which are entirely the responsibility of the Government itself. We believe holding private parties responsible for the performance of purely governmental functions is wrong to begin with. But when the Government is conducting its business in the interest of the general public, not in the interest of just a few private parties, such reimbursement practices are indefensible. The airlines urge that this matter be addressed through appropriate revisions to the customs overtime laws.

The remainder of our statement focuses on three areas of airline interest and proposes several ideas to resolve existing problems. First, the matter of informal entry preclearance. In the previous Congress legislation containing an informal entry provision was enacted, in large part due to the efforts of this subcommittee. The provision permits an in-

crease in the informal entry limit for most commodities to $1,250, up from $250, although the limit will be held for the time being to $1,000 by administrative ruling.

So that U.S. Customs inspectors at preclearance locations in Canada, Bermuda, and the Bahamas may retain and further enhance their cargo processing skills, as well as to facilitate preclearance of low value shipments, the airlines urge implementation of a procedure at these locations which will permit preclearance of all duty free informal merchandise. No moneys would be involved under this approach, and, therefore, problems of foreign currency transactions aboard would not arise. With the support of the subcommittee, we urge a test of this concept at a selected preclearance location as soon as possible.

Second, we urge the extension of preclearance to other locations abroad. The system of preclearance, inspection of passengers and their baggage for customs, immigration, and agriculture quarantine purposes prior to departure from a foreign country, rather than upon arrival in the United States, has been a tried and proven operational procedure at locations in Canada, Bermuda, and the Bahamas for over three decades.

Preclearance allows travelers to trickle in at foreign airports at their own pace and proceed through customs and immigration formalities in a leisurely fashion with ample time for as thorough inspection as required. This is in contrast to inspection after arrival in the United States when plane loads of persons disembark at a customs and immigration area with travelers from countries all over the world.

With preclearance, scheduled minimal connection times at U.S. airports are substantially reduced, and passengers are accepted for interline connections as if they had arrived on a domestic flight.

We, therefore, respectfully urge the support of the subcommittee in the extension of preclearance to select additional overseas locations. In Europe, for example, we recommend London, Shannon, Frankfurt, and Rome. In North America, we recommend Santo Domingo, Port Au Prince, and Mexico City, and in the Pacific we recommend Tokyo and Sidney. Preclearance of air travelers is one of the best operational measures yet devised to facilitate international air travel, and we urge the support of the subcommittee in obtaining its extension overseas on a priority basis.

Third, we suggest a variety of steps to maximize the benefits inherent in the trend toward computer processing of air cargo inventory and associated data necessary for customs entry. This matter is under intensive study at New York and Miami, where automated systems for import and export processing are being developed.

The airlines are concerned that the multiple approaches to automation at various gateways will lead to conflicts, duplication of efforts, and added costs. Variations among airport systems will generate problems for the users and the Customs Service. Unlike most other countries, the United States has many gateway airports to and between which airlines transport imported and inbound merchandise. Thus, the computer system at each gateway must be compatible with all others as well as with

any national air cargo computer system which may be developed by the U.S. Customs Service.

To address the need for a common discipline among these systems, we, therefore, urge that customs formulate guidelines which address standards for communications interconnections among the several important computer systems. We ask that these guidelines cover the design parameters for a large scale customs computer based information and teleprocessing system for the balance of this decade. These guidelines are in order to assure a uniform national customs automated air cargo system, a system which deals adequately with the interaction of local port authorities, forwarders, brokers, shippers, and airlines in the processing of exports as well as imports.

Perhaps the subcommittee would request the General Accounting Office to undertake a study of this important matter by detailing the costs involved, enforcement, and facilitation criteria, interfacing needs with the air cargo community and the interairport computer compatability considerations previously noted.

In examining customs' needs and requirements for air cargo computerization during the rest of this decade, the General Accounting Office could also examine air cargo computerized systems operations in other countries, for example, in England, France, and Japan. Knowledge of how these and other countries were able to resolve some of problems now facing the U.S. Customs Service would be of help in the formulation of any guidelines. Attention could also be given to the possibility in the future of intercountry customs computer interfacing systems.

Last, in order to provide inspection efficiencies and eventually reduce the number of Government inspectors along the United States-Canadian border, the airlines recommend implementation of a customs and immigration association for transborder travel. In view of the similarity of United States and Canadian customs, immigration, agriculture, and public health missions, problems, needs and requirements, such an association appears ripe for consideration by this subcommittee.

Under such a plan, for example, visitors admitted to one country would be admissible, in most cases, to the other country and could otherwise freely travel across the common border without further immigration inspection. This plan would also allow goods accompanying travelers crossing the United States-Canada border to be, within reason, duty exempt. Such an association concept could be considered first in terms of United States and Canadian citizen, with eventual application to overseas visitors.

Companion implementation of United States-Canada customs and immigration associations for transborder travel would eliminate the need for customs and immigration inspectors along the common border and at airports for transborder air travel.

In conclusion, we are concerned by customs' intention to eliminate 206 inspector positions which are currently unfilled. Rather than contemplating such a cut, more inspector positions should be added in the fiscal year 1986 budget to address continuing passenger and cargo proc-

essing delays at our gateway airports. In any event, customs will need to streamline its inspectional operations further and otherwise improve the efficiency of their management systems. The measures which we have outlined, namely, implementation of informal entry preclearance, formulation of customs cargo computerization guidelines, extension of preclearance to other locations abroad, construction of inspection facilities by the airlines at no cost to customs at terminals at Kennedy and Miami Airports and development a joint United States-Canada customs and immigration association will streamline and facilitate passenger and cargo inspection processing and will substantially reduce costs to the Government.

Thank you, Mr. Chairman, for this opportunity to offer our views.

PREPARED STATEMENTS

Senator ABDNOR. Thank you. You have made a number of proposals and suggestions. We are happy to have it. A number of problems exist with our budget. We have had cuts before in personnel and we have overcome it. This time it is getting more difficult. We certainly appreciate your statement and we will give it every consideration.

Thank you very much.

Senators Gorton and Evans requested that Seattle and Tacoma authorities' statements regarding the staffing levels of the Customs Service be made a part of the record and I ask unanimous consent that these statements be included at this point after Mr. Landry's statement.

[The statements follow:]

STATEMENT OF JAMES E. LANDRY

My name is James E. Landry. I am the Senior Vice President and General Counsel for the Air Transport Association of America, which represents most of the scheduled airlines of the United States. Seventeen of our member airlines provide regularly scheduled air service between the United States and more than 70 countries.

We appreciate this opportunity to offer several observations for the consideration of the subcommittee with respect to the FY 1986 appropriations for the U.S. Customs Service.

Before turning to those specifics, however, we wish to register three general comments regarding current Customs operations.

First, the airlines commend the U.S. Customs Service for implementing the dual passenger channel inspection system, commonly referred to as the red/green door procedure, at a number of U.S. gateway airports last year. The airlines now ask that this tried and proven procedure be extended to all other U.S. gateway airports.

Second, in order to cope with the international passenger traffic at the Miami and Kennedy International Airports, Eastern Air Lines should be permitted to construct Customs inspection facilities in its terminals at those two airports. These multi-million dollar Customs facilities will be built by Eastern at no cost to the government and in accordance with the exact specifications and dictates of the Customs Service. Northwest Airlines should also be permitted to construct similar Customs facilities in its satellite terminal at New York's Kennedy International Airport. Because of environmental impact and related considerations, and the huge costs involved, new commercial airports are no longer being built. In order to include a federal inspection agency area, the only option remaining to accommodate international air services is for an airline to remodel existing facilities. This is exactly what

Eastern and Northwest have requested authority to do, but they have been frustrated by lack of approval from the U.S. Customs Service, apparently because of the additional inspector staffing required.

Third, the airlines continue to be concerned over the requirement to reimburse the Customs Service for services performed outside of regular tours of duty during weekdays, including Saturdays, and between 5:00 p.m. and 9:00 a.m. on Sundays and holidays. This practice compels airlines to pay Customs employees over $10 million each year to perform duties and functions which are entirely the responsibility of the government itself. We believe holding private parties responsible for the performance of purely governmental functions is wrong to begin with. But when the government is conducting its business in the interest of the general public, not in the interest of just a few private parties, such reimbursement practices are indefensible. The airlines urge that this matter be addressed through appropriate revisions to the Customs overtime laws.

In a related hearing, the Air Transport Association testified before the Washington State Congressional delegation in Seattle, Washington. This informal hearing was held on February 15, 1985, to investigate the current and future operating procedures of the Customs Service. For the most part, the hearing focused on problems as they relate to Customs at the Seattle-Tacoma International Airport. However, the problems experienced and those discussed at the hearing are ones shared on a national level. The remainder of this statement focuses on three areas of airline interest and proposes several ideas to resolve existing problems.

I Informal Entry Preclearance

In the previous Congress, legislation containing an informal entry provision was enacted, in large part due to the efforts of this subcommittee. The provision permits an increase in the

informal entry limit for most commodities to $1,250 up from $250, although the limit will be held for the time being to $1,000 by administrative ruling.

So that U.S. Customs inspectors at preclearance locations in Canada, Bermuda and the Bahamas may retain and further enhance their cargo processing skills, as well as to facilitate preclearance of low value shipments, the airlines urge implementation of a procedure at these locations which will permit preclearance of all duty-free informal merchandise. No monies would be involved under this approach and, therefore, problems of foreign currency transactions abroad would not arise. With the support of the subcommittee, we urge a test of this concept at a selected preclearance location as soon as possible.

II Extension of Preclearance to Other Locations Abroad

The system of preclearance -- inspection of passengers and their baggage for Customs, Immigration and Agriculture quarantine purposes prior to departure from a foreign country, rather than upon arrival in the United States -- has been a tried and proven operational procedure at locations in Canada, Bermuda and the Bahamas for over three decades.

Preclearance allows travelers to "trickle" in at foreign airports at their own pace and proceed through Customs (and Immigration) formalities in a leisurely fashion with ample time for as thorough inspection as required. This is in contrast to inspection after arrival in the United States when planeloads of persons disembark at a Customs (and Immigration) area with travelers from countries all over the world.

With preclearance, scheduled minimal connection times at U.S. airports are substantially reduced, and passengers are accepted for interline connections as if they had arrived on a domestic flight.

We therefore respectfully urge the support of the Subcommittee in the extension of preclearance to select additional overseas

locations. In Europe, for example, we recommend London, Shannon, Frankfurt and Rome. In North America, we recommend Santo Domingo, Port au Prince and Mexico City; and in the Pacific we recommend Tokyo and Sydney. Preclearance of air travelers is one of the best operational measures yet devised to facilitate international air travel, and we urge the support of the Subcommittee in obtaining its extension overseas on a priority basis.

III Customs Cargo Computerization

Computer processing of air cargo inventory and associated data necessary for Customs entry is under intensive study at New York and Miami, where automated systems for import and export processing are being developed. The Miami Airport Authority has announced plans for a Miami International Cargo System, while the New York Port Authority has developed functional requirements for its Fast Flow System. We anticipate other U.S. gateway airports will develop their own systems in the not too distant future.

The airlines are concerned that the multiple approaches to automatation at various gateways will lead to conflicts, duplication of efforts, and added costs. Variations among airport systems will generate problems for the users and the Customs Service. Unlike most other countries, the United States has many gateway airports, to and between which airlines transport imported and in-bond merchandise. Thus, the computer system at each gateway must be compatible with all others as well as with any national air cargo computer system which may be developed by the U.S. Customs Service.

There is a need, accordingly, for a common discipline among these sytems and the airlines therefore request the formulation of guidelines by Customs which address standards for communications interconnections among the several port computer systems. We ask that these guidelines cover the design parameters for a large scale Customs computer based information and tele-processing system for the balance of this decade. These guidelines are in

order to assure a uniform national Customs automated air cargo system, a system which deals adequately with the interaction of local port authorities, forwarders, brokers, shippers and airlines in the processing of exports as well as imports.

Perhaps the subcommittee could request the General Accounting Office to undertake a study of this important matter by detailing the costs involved, enforcement and facilitation criteria, interfacing needs with the air cargo community, and the inter-airport computer compatibility considerations previously noted.

In examining Customs needs and requirements for air cargo computerization during the rest of this decade, the General Accounting Office could also examine air cargo computerized systems operations in other countries, for example, in England, France and Japan. Knowledge of how these and other countries were able to resolve some of the problems now facing the U.S. Customs Service would be of help in the formulation of any guidelines. Finally, attention could also be given to the possibility in the future of inter-country Customs computer interfacing systems.

IV U.S.-Canada Customs Association

In order to provide inspection efficiencies and eventually reduce the number of Immigration inspectors along the U.S.-Canadian border, the airlines recommend implementation of a Customs and Immigration association for transborder travel. In view of the similarity of United States and Canadian Customs, Immigration, Agriculture and Public Health missions, problems, needs and requirements, such an association appears ripe for consideration by this subcommittee.

Under such a plan, for example, visitors admitted to one country would be admissable, in most cases, to the other country and could otherwise freely travel across the common border without further immigration inspection. This plan would allow goods accompanying travelers crossing the U.S.-Canada border to be, within reason, duty exempt. Such a Customs association concept

could be considered first in terms of U.S. and Canadian citizens, with eventual application to overseas visitors.

Companion implementation of U.S.-Canada Customs and Immigration associations for trans-border travel would eliminate the need for Customs and Immigration inspectors along the common border and at airports for trans-border air travel.

Conclusion

In conclusion, we are concerned by Customs' intention to eliminate 206 inspector positions which are currently unfilled. Rather than contemplating such a cut, more inspector positions should be added in the FY 1986 budget to address continuing passenger and cargo processing delays at our gateway airports. In any event, Customs will need to streamline its inspectional operations further and otherwise improve the efficiency of their management systems. The measures which we have outlined, namely, implementation of informal entry preclearance, formulation of Customs cargo computerization guidelines, extension of preclearance to other locations abroad, construction of inspection facilities by the airlines at no cost to Customs at terminals at the Kennedy and Miami airports, and development of a joint U.S.-Canada Customs and Immigration association will streamline and facilitate passenger and cargo inspection processing and will substantially reduce costs to the Government.

STATEMENT OF HAROLD L. SCHUYLER, VICE PRESIDENT, PUGET SOUND STEAMSHIP OPERATORS ASSOCIATION

Today, I am giving testimony on behalf of the Puget Sound Steamship Operators Association, of which I am vice president. The Association represents 32 steamship operators and agents in the Pacific Northwest area.

I am also director of Public Affairs for the Alaska Division of the U.S.-flag containership carrier Sea-Land Service, Inc., a member of

the Association and a major carrier in the area. I have been associated with Sea-Land for more than 19 years.

The Association wishes to thank you in advance for permitting us, as members of the shipping community, to testify regarding the problems we face with the present shortage of U.S. Customs Inspectors and the impact of anticipated further reductions in staff on our Pacific Northwest steamship operations.

We are concerned that any Customs reorganization or staff reduction that is not fully thought out and discussed will not only inhibit intermodal growth, but will increase transportation costs -- costs that will ultimately be borne by the consumer.

Further, we believe a shortage of Customs inspectors on the West Coast will:

- one, frustrate our nation's foreign trade objectives;
- two, reduce the competitiveness of U.S. imports and exports alike; and
- three, threaten the integrity of the entire U.S. transportation network.

Because of the increased workload at Pacific Coast ports brought about by the rapid growth of international commerce, particularly between the U.S. and Pacific Rim countries, the Customs Service is having a difficult time in keeping up with import/export traffic. In fact, its staff has decreased as its work has increased.

Briefly, I would like to give you an idea of how steamship operators work and how crucial an efficient Customs Service is to our operations.

Today, speed and efficiency are the cornerstones of any successful, cost-effective intermodal service -- both from the point of view of the customer and the steamship operator.

The basic advantage of containerization to the steamship operator is productivity -- substantially reducing the time and labor costs in transporting goods. Any delays due to Customs congestion inhibit this productivity, increase costs and reduce profitability.

Before a vessel even arrives at a port, a steamship company employs a computer simulation to plan the orderly disposition of cargo. To expedite cargo routing, extra labor is scheduled to handle vessel discharge operations, and both contract longshore and full-time office workers coordinate operational plans and documentation so that the containers coming off a ship are placed in the proper parking slots for immediate Customs clearance. After Customs clearance, the cargo must meet the scheduled departure of the connecting land carrier -- whether it be truck or rail.

If, for example, there is congestion in Customs and a shipment misses a scheduled unit train departure, a delivery delay of as much as a week could result. In that case, the steamship operator has incurred substantial labor expense in an unsuccessful attempt to speed cargo distribution. Cargo which does not move must be stored by the steamship operator, and this storage becomes yet another expense.

To lower expensive warehousing costs, many of our customers are turning to "just in time" or "zero inventory" production timetables. Because inventory stocks are kept to a minimum, production and distribution hinge on timely cargo delivery. Late arrivals due to Customs back-ups create costly production, distibution and sales delays for our customers.

Further, any delay in cargo movement is costly not only to our customers but to all modes of transportation. Each mode in an intermodal operation must strive to stay on schedule to make the network efficient.

Notably, there has been a dramatic increase in intermodal rail shipments over West Coast ports. Just to give you an idea of volume

increases in rail traffic, my Company alone moved an average of 3,000 containers each week across the U.S. in 1984, compared with fewer than 100 containers a decade ago.

In the last seven years, the total tonnage moving through the Seattle District has increased 86 percent. Total Customs duties collected have increased 193 percent. And total cargo entries, that is the number of shipments clearing Customs, have increased 135 percent.

Not only has there been no commensurate increase in Customs staff to handle this markedly increased volume, but the number of Inspectors, Import Specialists and Clerks has actually decreased.

In the Puget Sound area, the Seattle District is charged with the following responsibilities:

- Marine traffic at all Washington ports with the exception of those ports on the Columbia River, which come under the Portland District. This includes all pleasure craft entering and clearing from Washington waters and Canada.

- Airport traffic at Sea-Tac and Boeing Field for all passenger traffic and air cargo. The District also must answer requests from various small aircraft entering and clearing at various airports in the State from Canada.

- All border crossings between the State of Washington and British Columbia, Canada. Blaine is the largest, with a 24-hour operation serving automobile, railroad and truck traffic for passengers and cargo.

Additional projects that are on the Customs Service agenda include:

- Accept Program - A program which has considerable merit in assisting Customs and the shipping public in processing

paperwork through use of computerized input of a ship's cargo manifest. This program was developed by Customs with the cooperation of the steamship companies.

- o Exodus Program - Request by the Defense Department to the Commerce Department for the Customs Service to implement.

- o Drug Programs - There are several of these programs, all of which require staff to perform the job.

- o Heathrow Program - A project to keep tabs on the whereabouts of suspect terrorist types.

- o Commodity Quotas - Another area which has increased the Service workload is the various quotas established for certain U.S. import commodities. This project must be kept up-to-date in order for Customs to carefully monitor and report.

I would like to note that Customs Service works on a 5-day per week basis during a 6-day period. Nights and Sundays are at overtime rates charged to those requiring their services. Further, Customs personnel are limited to the amount of dollars each inspector may earn in overtime pay per year.

The reason for citing the duties and the work week regulations of the Customs Service is to underscore that:

- o All of these projects and programs are important to the nation.

- o The number of Inspectors, Import Specialists and Clerks has decreased when it should have increased to handle the extra volume and workload.

- The Government is actually hindering the ability of the Customs Service to do the job they were chartered to do because of budgeting practices.

- Since the Customs Service is not hiring any new staff, Inspector- and Cargo Specialist-level staff are frequently moved to work on special projects or on computers -- jobs that could be handled by lower-level clerks.

- The heavy workload, the overtime requests and the added programs I mentioned earlier, without extra staff, are certainly not conducive either to speed and efficiency or to healthy work morale for a public service.

In the Association's opinion, the Seattle District requires at least 50 additional staff to meet present Customs needs in four key areas of concern: the Tacoma Waterfront; Seattle Waterfront; Sea-Tac International Airport; and Blaine Border. Currently, the Seattle District is trying to cover the workload with 173 people assigned to 22 locations in the State. However, at the four areas of concern, there are only 123 people in various categories, plus 37 assigned to Special Projects (see attachment).

Clearly, staffing and other administrative changes fall within the purview of the Customs Service. But decisions affecting the integrity of the international transportation network are crucial to the well-being of our nation's foreign trade and go right to the heart of America's economic security. Decisions of this magnitude should evolve from an open dialogue between the parties concerned, not unilateral executive fiat.

In no way are we here to criticize the United States Customs Service or the Pacific Region or Seattle District. The Customs Service needs help in order to perform its duties efficiently. It is evident that this help must come from Congress.

Attachment #1

UNITED STATES CUSTOMS SERVICE

SEATTLE DISTRICT

Actual tonnages which were loaded/unloaded across the docks of the United States Customs Service, Seattle District, starting with fiscal year 1977 through fiscal year 1984. These figures are from the Pacific Maritime Association's records. Ports included in the tonnage records are: Bellingham, Seattle, Tacoma, Aberdeen/ Raymond, Anacortes, Port Angeles/Port Townsend, Everett, Olympia and Port Gamble. These are the ports which are covered by the Customs Service Seattle District.

The figures are broken out into several categories: Lumber and Logs, Automobiles, Container Cargo, General Cargo, Dry Bulk and the total. As you will note, there are no liquid cargoes involved in these figures, as tankers do not use longshore labor.

In 7 years, when comparing the 1977 Total Tonnage and the 1984 Total Tonnage, there has been an 86.4% increase in growth as follows:

Lumber and Logs	(00.2%)
Automobiles	56.9%
Container Cargo	130.5%
General Cargo	1.2%
Dry Bulk	115.8%
Total	86.4% Increase

The Customs work load increased as far as inspecting their required percentage of cargoes. Lumber and Logs have never required too much inspection. Automobile inspection has increased because of the increased number. Container cargo, which constitutes a wide variety of commodities as well as values of these commodities has increased. General Cargo has not increased that much in six years. Dry Bulk has increased; however, it does not require as much from the Inspectors.

WASHINGTON CUSTOMS DISTRICT HARBOR TONNAGES FROM PACIFIC MARITIME ASSOCIATION

COMPARED TO U. S. FISCAL YEAR (OCTOBER TO SEPTEMBER)

	LUMBER/LOGS	AUTOMOBILES	CONTAINERS	GENERAL	DRY BULK	TOTAL TONNAGE
1977	3,080,373	1,506,643	6,047,685	1,163,419	4,909,135	16,707,255
1978	3,302,523	1,858,480	6,656,336 .107%	1,192,517	6,077,030	19,126,886
1979	3,850,548	2,227,989	7,097,064 .059%	1,249,236	8,728,112	23,152,949
1980	3,321,235	2,871,714	8,181,753 .152%	1,441,551	11,718,720	27,534,973
1981	2,290,339	2,310,920	9,002,639 .100%	1,435,371	12,144,288	27,183,557
1982	2,746,472	1,978,018	9,714,474 .079%	1,257,492	8,042,292	23,738,748
1983	3,247,114	1,880,266	10,665,894 .097%	1,170,298	7,186,705	24,150,277
1984	3,074,358	2,364,122	13,942,406 .307%	1,177,673	10,596,455	31,155,014
1984 Vs. 1977 Inc/(Dec)	(.2%)	+56.9%	+130.5%	+ 1.2%	+115.8%	+86.4%

Attachment #2

Attachment #3

U. S. CUSTOMS SERVICE SEATTLE DIVISION

COLLECTION OF DUTIES & FINES AND CARGO ENTRIES - 1977 THROUGH 1984 FISCAL

	DUTY DOLLARS	CARGO ENTRIES
1977	$191,000,000	134,000
1978	N/A	N/A
1979	292,000,000	182,000
1980	314,000,000	184,000
1981	386,000,000	189,000
1982	410,000,000	191,000
1983	396,000,000	259,000
1984	559,000,000	315,000
	Inc. 192.6%	Inc. 135.1%

U. S. CUSTOMS SERVICE
CATEGORIES OF OCCUPATIONS

	Chiefs	Super-visor	Port Directors	Import Spec.	Inspectors	Headcount Total	Spec.Proj.	Total People
Metaline Falls			1		1	2		2
Boundary							Immigration Only	
Frontier			1		1	2		2
Danville			1		1	2		2
Lourier			1		1	2		2
Ferry			1			1		1
Nighthawk					1	1		1
Oroville		1	1		6	8		8
Sumas		1	1		8	10		10
Lynden			1		5	6		6
Point Roberts					1	1		1
Spokane		1			1	2		2
Bellingham			1		1	2		2
Anacortes			1		2	3		3
Port Townsend			1			1		1
Everett			1			1		1
Friday Harbor			1		1	2		2
Aberdeen			1			1		1
Port Angeles			1		2	3		3
Blaine	1	5		8	32	46	(4)	42
Tacoma		1		2	11	14	(3)	11
Sea-Tac (Air)		5			32	37	(7)	30
Seattle (Water)	2	4	1	25	32	63	(23)	40
Sub-Total	3	18	15	35	139	210	(37)	173
Imp.Spec./Spec.Proj.				(9)		(9)		
Insp., Assigned Spec. Proj.					(28)	(28)		
TOTAL	3	18	15	26	111	173		

Attachment #4

Attachment #5

Puget Sound Steamship Operators Assn., Inc.
120 Third Avenue
Suite 2300
Seattle, Washinton 98104

1985 MEMBERSHIP LIST
(As of January 1, 1985)

American President Lines
Terminal 46
401 Alaskan Way S.
Seattle, WA 98104

Beaufort Navigation, Inc.
Bank of California Center
Suite 1050
Seattle, WA 98164

Cascade Shipping Co.
2701 First Avenue
Suite 400
Seattle, WA 98121

Crowley Maritime Corp.
P.O. Box 2287
Seattle, WA 98111

Dodwell of Washington
2099 Sixth Avenue
Suite 1150
Seattle, WA 98121

EAC Lines
1411 Fourth Avenue Bldg.
Seattle, WA 98101

Evergreen Marine Corp.
(Calif.) Ltd.
999 3rd Avenue
10th Floor
Seattle, WA 98104

Foss Alaska Line, Inc.
c/o Foss Launch & Tug
660 W. Ewing Street
Seattle, WA 98119

Freighters Company
810 3rd Avenue
Suite 258
Seattle, WA 98104

Fritz Maritime Enterprises
P.O. Box 88196
Seattle, WA 98188

General Steamship Corp., Ltd.
2101 Fourth Avenue
Suite 1400
Seattle, WA 98121

Hanjin Container Lines, Ltd.
157 Yesler Way
Suite 615
Seattle, WA 98104

Hapag-Lloyd Agencies
301 Norton Bldg.
Seattle, WA 98104

International Shipping Co.
400 Norton Bldg.
Seattle, WA 98104

Interocean Steamship Corp.
618 Second Avenue
Suite 1200
Seattle, WA 98104

Kansai Steamship Company
2701 First Avenue
Seattle, WA 98121

Kerr Steamship Company
800 Fifth Avenue Plaza
Suite 3550
Seattle, WA 98104

Matson Navigation Company
720 Third Avenue
Suite 2300
Seattle, WA 98104

Merit Steamship Agency, Inc.
801 Second Avenue
Suite 1001
Seattle, WA 98104

Norton Lilly Co., Inc.
Park Center 1
Suite 220
33400 Eigth Avenue, S.
Federal Way, WA 98003

Olympic Steamship Co., Inc.
P.O. Box 24023
Seattle, WA 98124

Sea-Land Service, Inc.
4800 S. 188th Street
Suite 310
Seattle, WA 98188

Seapac Services, Inc.
709 Seattle Tower
1218 Third Avenue
Seattle, WA 98101

Showa Maritime USA, Inc.
801 Second Avenue
Room 203
Seattle, WA 98104

Star Shipping (U.S.W.C.) Inc.
80 Yesler Way
Seattle, WA 98104

J.T. Steeb & Co., Inc.
318 Norton Bldg.
Seattle, WA 98104

Sunrise Shipping Agency, Inc.
150 Nickerson Street
Suite 207
Seattle, WA 98109

Totem Ocean Trailer Express
Marine Operations
500 Alexander Avenue
Tacoma, WA 98421

Transmarine Navigation Corp.
9750 Third Avenue, NE
Suite 201
Seattle, WA 98115

Transpacific Transportation Co.
1915 Pacific Bldg.
Seattle, WA 98104

Weyerhaeuser Company
CH 2-6
Tacoma, WA 98401

Williams Dimond & Company
1515 Pacific Bldg.
Seattle, WA 98104

STATEMENT OF JACK BLOCK, ELECTED MEMBER, PORT OF SEATTLE COMMISSION

MY NAME IS JACK BLOCK. I AM AN ELECTED MEMBER OF THE PORT OF SEATTLE COMMISSION AND AM HERE REPRESENTING MYSELF AND OTHER MEMBERS OF THE COMMISSION.

I APPRECIATE THIS OPPORTUNITY TO APPEAR AND SPEAK BEFORE THE SUBCOMMITTEE ON THE FISCAL YEAR 1986 CUSTOMS SERVICE APPROPRIATION.

THE PORT OF SEATTLE OWNS SEATTLE-TACOMA INTERNATIONAL AIRPORT, ONE OF THE NATION'S LARGEST AIRPORTS WITH MORE THAN 10 MILLION PASSENGERS EACH YEAR. OUR WATERFRONT FACILITIES HANDLED MORE THAN ONE MILLION CONTAINERS LAST YEAR. SEATTLE IS THE LARGEST CONTAINER PORT ON THE WEST COAST, AND THE THIRD LARGEST IN THE NATION.

I'D LIKE TO TAKE A MOMENT TO THANK THE CHAIRMAN AND MEMBERS OF THIS SUBCOMMITEE FOR THEIR PAST UNDERSTANDING AND SUPPORT. THE SUBCOMMITTEE'S EFFORT TO MAINTAIN NECESSARY FUNDING FOR THE CUSTOMS SERVICE IS APPRECIATED. IN PARTICULAR, WE WERE PLEASED TO HAVE AN OPPORTUNITY TO EXPLAIN OUR DIFFICULTIES TO THE

CHAIRMAN DIRECTLY DURING A FIELD HEARING ON FEBRUARY 15TH IN SEATTLE: THANK YOU FOR TAKING THE TIME TO COME TO SEATTLE TO RESEARCH THIS PROBLEM.

THE VOLUME OF TRADE HAS GROWN RAPIDLY IN SEATTLE OVER THE LAST DECADE. IN THE TEN YEAR PERIOD SINCE 1973, CONTAINERIZED CARGO IMPORTED INTO SEATTLE GREW 270 PERCENT. SINCE 1979, THE VALUE OF SEATTLE'S IMPORTED MARINE CARGO HAS INCREASED 51 PERCENT. INTERNATIONAL AIR PASSENGER ARRIVALS ARE UP 107 PERCENT OVER THAT SAME FIVE YEAR PERIOD, AND AIR CARGO IMPORTS HAVE GROWN 24 PERCENT.

IN 1984, MORE THAN HALF A MILLION INTERNATIONAL AIR PASSENGERS ENTERED THE UNITED STATES THROUGH SEA-TAC INTERNATIONAL AIRPORT. OVER 4 MILLION METRIC TONS OF MARINE CARGO CROSSED OUR DOCKS, AND NEARLY 25 MILLION POUNDS OF AIR CARGO ENTERED THE NATION THROUGH SEA-TAC.

AS THESE FIGURES INDICATE, TRADE AND TOURISM HAVE GROWN SUBSTANTIALLY IN THE PORT OF SEATTLE DURING THE LAST FIVE YEARS. CUSTOMS STAFFING HAS NOT KEPT PACE. THE NUMBER OF PEOPLE AVAILABLE TO PERFORM INSPECTION, CLASSIFICATION, DUTY REVIEW AND PROCESSING TASKS IS ACTUALLY DECREASING.

THESE STAFF REDUCTIONS ARE CAUSING DELAYS, AND COULD PRECIPITATE LAW ENFORCEMENT PROBLEMS IN THE FUTURE OF OUR PORT. IN ADDITION, STAFFING SHORTAGES CAN IMPACT MAJOR SECTORS OF OUR NATIONAL ECONOMY.

INTERNATIONAL TOURISM, FOR EXAMPLE, IS A MAJOR U.S. EXPORT INDUSTRY, IMPROVING OUR BALANCE OF TRADE SIGNIFICANTLY. WHEN BORDER MANAGEMENT POLICIES MAKE IT DIFFICULT OR UNATTRACTIVE FOR FOREIGN VISITORS TO ENTER THIS COUNTRY, WE ARE LIMITING THE GROWTH OF THAT INDUSTRY TO OUR OWN ECONOMIC DETRIMENT.

LIKEWISE, DELAYS IN PROCESSING SHIPMENTS OF MERCHANDISE INCREASE THE COST OF DOING BUSINESS IN THE INTERNATIONAL MARKETPLACE. THAT INCREASES THE COST OF GOODS TO THE AMERICAN CONSUMER, AND MAKES IT MORE DIFFICULT FOR U.S. COMPANIES TO COMPETE IN INTERNATIONAL TRADE.

ADEQUATE CARGO AND PASSENGER FACILITATION BY CUSTOMS IS A NATIONAL PROBLEM THAT IS GETTING WORSE AS THE WORLD ECONOMY IMPROVES, AND TRAVEL AND TOURISM INCREASE.

THE ADMINISTRATION'S PROPOSED FISCAL YEAR 1986 BUDGET FOR THE CUSTOMS SERVICE, IF APPROVED, WILL EXACERBATE THIS GROWING PROBLEM. CARGO VOLUME HAS BEEN INCREASING NATIONWIDE, AND PARTICULARLY ON THE WEST COAST. YET THE ADMINISTRATION HAS RECOMMENDED A CUT IN PERSONNEL FOR THE CUSTOMS SERVICE OF MORE THAN 800 POSITIONS.

IN FACT, AS CUSTOMS BUDGETS HAVE BEEN THREATENED OVER THE LAST FIVE YEARS, THE NUMBER OF FORMAL ENTRIES OF MERCHANDISE HAS INCREASED BY 28 PERCENT NATIONALLY. CUSTOMS REVENUE COLLECTIONS GREW 16 PERCENT OVER THAT SAME PERIOD.

FOR AN INVESTMENT OF $700 MILLION LAST YEAR, THE CUSTOMS SERVICE BROUGHT IN REVENUES OF MORE THAN $12 BILLION. CUSTOMS INSPECTORS EARN MORE THAN $17 IN REVENUE FOR THE TREASURY FOR EVERY DOLLAR WE PAY THEM.

DESPITE THIS RETURN ON INVESTMENT, THE NUMBER OF INSPECTORS AND IMPORT SPECIALISTS AVAILABLE NATIONALLY TO CLASSIFY AND REVIEW ENTRIES DECLINED FROM A 1979 TOTAL OF 5,410 TO 5,331 IN 1984. IN THAT FIVE YEAR PERIOD, THE WORKLOAD FOR EACH INSPECTOR GREW 20 PERCENT. FOR IMPORT SPECIALISTS, WORKLOAD GREW 52 PERCENT, MEASURED IN THE NUMBER OF FORMAL ENTRIES OF MERCHANDISE PER INDIVIDUAL.

ACCORDING TO REPLIES PROVIDED IN TESTIMONY TO THIS SUBCOMMITTEE TREASURE APPROPRIATIONS SUBCOMMITTEE EARLIER THIS YEAR BY CUSTOMS COMMISSIONER WILLIAM VON RAAB, THE NUMBER OF ENTRIES THROUGH THE SEATTLE DISTRICT HAS INCREASED 69.7 PERCENT SINCE FISCAL YEAR 1980.

THE NUMBER OF DUTIABLE ENTRIES IN THE PACIFIC REGION INCREASED BY APPROXIMATELY 20 PERCENT IN FY 1983, AND BY 21 PERCENT IN FY 1984. THE CUSTOMS SERVICE EXPECTS "A CONTINUATION OF THIS TREND (20 PERCENT A YEAR) DURING THE NEXT FIVE YEARS", ACCORDING TO A LETTER FROM DEPUTY COMMISSIONER DE ANGELUS TO CONGRESSMAN DICKS DATED MARCH 28, 1985.

YET IN HIS TESTIMONY TO THIS SUBCOMMITTEE, COMMISSIONER VON RAAB ACKNOWLEDGED THAT "THE NUMBER OF CUSTOMS INSPECTORS IN SEATTLE HAS DECREASED 8.5 PERCENT SINCE FY 80, IN COMPARISON TO THE NATIONAL INCREASE of .6 PERCENT".

LET ME POINT OUT THAT DURING THIS SAME FIVE YEAR PERIOD - - WHILE OUR STAFF WAS DECLINING - - REVENUE COLLECTIONS IN THE SEATTLE DISTRICT OUTPACED THE NATIONAL GROWTH RATE. SEATTLE'S CUSTOMS COLLECTIONS GREW 37 PERCENT FROM FY 80 THROUGH FY 84, WHILE THE NATIONAL GROWTH IN COLLECTIONS WAS ONLY 16 PERCENT. IN FISCAL YEAR 1984, SEATTLE RANKED FIFTH IN THE NATION IN TOTAL CUSTOMS COLLECTIONS.

TO HANDLE AN INCREASING WORKLOAD WITH A SMALLER STAFF, CUSTOMS HAS INITIATED A NUMBER OF STREAMLINED PROCEDURES FOR PROCESSING INCOMING CARGO AND PASSENGERS. THOSE PROCEDURES HAVE BEEN QUITE EFFECTIVE IN THE SEATTLE CUSTOMS DISTRICT, IN LARGE PART BECAUSE OF THE COOPERATION BETWEEN THE TRADING COMMUNITY, THE PORTS, AND THE CUSTOMS SERVICE DISTRICT OFFICE.

FOR EXAMPLE, SEATTLE HAS ENJOYED A SMOOTH TRANSITION TO THE ACCEPT SYSTEM AT OUR WATERFRONT, AND WE ARE LOOKING FORWARD TO IMPLEMENTING THE AUTOMATED BROKER INTERFACE NETWORK THIS FALL. WE ALSO EXPECT TO HAVE A RED LIGHT/GREEN LIGHT SYSTEM IN OPERATION AT SEA-TAC AIRPORT IN TIME FOR OUR SUMMER PEAK PERIOD THIS YEAR. BUT THE INVESTMENT THE PORT OF SEATTLE HAS MADE IN THESE SYSTEMS - - WHICH TOTALS MORE THAN $18 MILLION OVER THE LAST FOUR YEARS - - IS ALMOST USELESS WITHOUT ADEQUATE CUSTOMS PERSONNEL TO STAFF OUR DOCKS, WHARVES AND TERMINALS.

AT THE AIRPORT, WE RECENTLY EXPANDED OUR PASSENGER AND BAGGAGE HANDLING AREAS. WE CAN NOW ACCOMMODATE 1,000 PASSENGERS AND THEIR BAGGAGE EVERY HOUR. BUT UNDERSTAFFING BY CUSTOMS SLOWS THAT RATE TO APPROXIMATELY 500 PASSENGERS PER HOUR.

SIMILARLY, AT THE WATERFRONT, ISLAND JETFOIL CORPORATION HAD PLANS TO BEGIN A NEW HYDROFOIL SERVICE BETWEEN SEATTLE, AND VANCOUVER AND VICTORIA, BRITISH COLUMBIA. THE SERVICE WAS SET TO START ON MARCH 1. BECAUSE OF INADEQUATE CUSTOMS STAFFING, THE FIRST FLIGHT OF THE HYDROFOIL HAS BEEN PUSHED BACK TO APRIL 19 - - A DELAY OF MORE THAN A MONTH. MORE THAN $11.5 MILLION HAS BEEN INVESTED BY PRIVATE BACKERS IN THIS NEW VENTURE, AND THE DELAY THEY'VE EXPERIENCED HAS COST THEM AN ADDITIONAL $500,000. ALL THEY NEED IS TWO CUSTOMS INSPECTORS FOR TWO HOURS A DAY. BUT THOSE AGENTS ARE NOT AVAILABLE. AS A RESULT, A NEW BUSINESS HAS BEEN JEOPARDIZED, NE JOBS AND NEW REVENUE MAY BE LOST, AND SEATTLE'S REPUTATION AS A PORT OF ENTRY IS FURTHER DAMAGED.

MR. CHAIRMAN, DISTINGUISHED MEMBERS OF THIS SUBCOMMITTEE, IN THE PAST WE HAVE SIMPLY ASKED YOU TO RESTORE FUNDING TO THE CUSTOMS SERVICE TO ALLOW STAFFING LEVELS TO BE MAINTAINED, AND TO GUARANTEE THAT SERVICE LEVELS NATIONALLY WOULD NOT DECLINE.

THIS YEAR, OUR REQUEST IS MORE DIRECT. THIS YEAR, WE WOULD LIKE YOU TO CONSIDER THE NATIONAL DISTRIBUTION OF CUSTOMS PERSONNEL, AND READJUST THAT DISTRIBUTION TO BETTER HANDLE THE INCREASED WORKLOAD ON THE WEST COAST. SPECIFICALLY, THE PORT OF SEATTLE RECOMMENDS THE ADDITION OF SIXTY NEW INSPECTOR POSITIONS WITHIN THE SEATTLE DISTRICT. THAT DISTRICT, AS YOU KNOW, COVERS MOST OF THE STATE OF WASHINGTON, AND INCLUDES THE GROWING PORT OF TACOMA, BLAINE AND SEATTLE. IT IS AN AREA WHICH HAS SEEN ITS SHARE OF INTERNATIONAL TRADE EXPAND RAPIDLY IN THE LAST SEVERAL YEARS. AS COMMISSION VON RAAB, HIMSELF, POINTED OUT, THE NUMBER OF ENTRIES THROUGH THE SEATTLE DISTRICT HAS INCREASED 69.7 PERCENT SINCE FY 80. YET OUR STAFFING RESOURCES HAVE DECLINED 8.5 PERCENT DURING THAT TIME.

THERE ARE PRESENTLY 140 INSPECTORS ON DUTY IN THE SEATTLE DISTRICT. THE ADDITION OF THE 60 NEW POSITIONS RECOMMENDED BY THE PORT OF SEATTLE WOULD BRING OUR TOTAL TO 200 INSPECTORS, AND ENABLE CUSTOMS TO MORE EFFECTIVELY COVER THE INCREASING TRAFFIC LOAD IN THE SEATTLE DISTRICT.

LET ME DISCUSS OUR REQUESTS FOR SEATTLE FOR A MOMENT. WE HAVE ASKED FOR 10 ADDITIONAL INSPECTORS FOR SEA-TAC AIRPORT. THE MAJORITY OF OUR INTERNATIONAL FLIGHTS ARRIVE IN THE MORNING BETWEEN 9:00 A.M. and 12:00 NOON. IT WOULD BE MOST USEFUL TO HAVE THESE POSITIONS DESIGNATED AS PERMANENT PART-TIME POSITIONS. THIS WOULD GIVE THE DISTRICT THE FLEXIBILITY TO FILL EACH SLOT WITH TWO PART-TIME PEOPLE, EACH AVAILABLE FOR ASSIGNMENT DURING THE MORNING PEAK HOURS. THE ADDITION OF 10 NEW INSPECTORS WOULD BRING THE SEA-TAC COMPLEMENT UP FROM ITS CURRENT LEVEL OF 32 INSPECTORS TO A LEVEL OF 42 AGENTS. ABOUT A THIRD OF THOSE INDIVIDUALS WOULD PERFORM CARGO INSPECTION TASKS, AND TWO-THIRDS WOULD BE AVAILABLE FOR PASSENGER PROCESSING. THIS WOULD PERMIT STAFFING OF THE MAJORITY OF THE AIRPORT'S PRIMARY INSPECTION LANES AS WELL AS THE SECONDARY

AREAS, WHILE STILL ALLOWING AGENTS TO ACT AS ROVERS WITHIN THE CROWD OF ARRIVING PASSENGERS, AND RESPOND TO DRUG ENFORCEMENT OR OTHER PROBLEMS.

SEATTLE'S HARBOR CURRENTLY HAS AN INSPECTION STAFF OF TWENTY-THREE, WITH AN ADDITIONAL TEN AGENTS ASSIGNED TO CONTRABAND ENFORCEMENT TEAMS OR OPERATION EXODUS DUTIES. WE RECOMMEND THE ADDITION OF 19 NEW POSITIONS AT THE HARBOR, TO GIVE THE DISTRICT FLEXIBILITY TO RESPOND TO NEW GROWTH IN TRAFFIC.

APPROXIMATELY 70 PERCENT OF SEATTLE'S INCOMING CARGO ORIGINATES IN THE FAR EAST. MUCH OF IT IS TEXTILES, TOYS AND ELECTRONIC GOODS - - IMPORTS WHICH ARE HIGH-RISK AND REQUIRE EXTRA VIGILANCE ON THE PART OF THE CUSTOMS AGENT. CARGO OF THIS KIND DEMANDS MORE DETAILED EXAMINATION BY CUSTOMS. TEXTILES ARE QUOTA MERCHANDISE, AND MUST BE CAREFULLY MONITORED. TOYS ARE OFTEN EXAMINED FOR COUNTERFEIT AND TRADEMARK VIOLATIONS TO SAFEGUARD DOMESTIC MANUFACTURERS. SHIPMENTS ORIGINATING IN THE FAR EAST HAVE A HIGHER RISK OF DRUG AND CONTROLLED SUBSTANCE VIOLATION, AND OFTEN MUST BE CAREFULLY EXAMINED. ALL OF THIS TAKES MANPOWER - - MANPOWER THAT CUSTOMS IS CURRENTLY LACKING IN SEATTLE. THE ADDITION OF 19 NEW POSITIONS WOULD BETTER EQUIP CUSTOMS TO DO ITS JOBS, AND RESPOND TO THE GROWING VOLUME OF COMMERCE THROUGH OUR PORT.

IN CLOSING, MR. CHAIRMAN, LET ME SAY AGAIN HOW APPRECIATIVE I AM TO HAVE THIS OPPORTUNITY TO DISCUSS SEATTLE'S NEEDS WITH YOU AND THE MEMBERS OF OUR SUBCOMMITTEE. I KNOW WHAT A DIFFICULT TASK YOU HAVE BEFORE YOU IN ALLOCATING A LIMITED AMOUNT OF FUNDING TO A LARGE NUMBER OF AGENCIES. BUT AS YOU ARE AWARE, WITHOUT CUSTOMS, INVESTMENTS MADE BY PRIVATE ENTITIES AND LOCAL GOVERNMENTS TO PROMOTE TRADE CAN BE RENDERED WORTHLESS.

A REGION SHOULD NOT PENALIZED FOR EXPERIENCING A GROWTH IN TRADE; IT SHOULD BE ENCOURAGED. YET INADEQUATE CUSTOMS STAFFING DISCOURAGES GROWTH. CUSTOMS SHOULD NOT BE THE DECIDING FACTOR IN THE COMPETITION FOR BUSINESS BETWEEN PORTS; INSTEAD PORTS SHOULD BE "CUSTOMS NEUTRAL". BUSINESS DECISIONS SHOULD BE MADE ON THE BASIS OF FACILITIES RATHER THAN ON THE BASIS OF THE TIME IT TAKES TO CLEAR CARGO OR PASSENGERS THROUGH CUSTOMS.

WHEN CUSTOMS STAFFING IS CUT, AS IT HAS BEEN IN THE SEATTLE DISTRICT, BUSINESS IS IMPEDED. IN OTHER ASPECTS OF OUR OPERATION, IF WE DISCOVER A BOTTLENECK OR DIFFICULTY, WE TAKE STEPS TO FIX IT. WE BUY LAND, OR CONSTRUCT A PIER, OR BUILD A NEW TERMINAL. BUT IN THE CASE OF CUSTOMS, WE AS A PORT CANNOT MAKE AN INVESTMENT AND SEE THE PROBLEM CORRECTED. WE HAVE DONE WHAT WE CAN TO IMPROVE THE OPERATION WITH CURRENT CUSTOMS RESOURCES. WE HAVE WORKED WITH CUSTOMS OFFICIALS TO IMPROVE THEIR FACILITIES. INDEED, THEY HAVE INCREASED THEIR PRODUCTIVITY TREMENDOUSLY IN THE LAST DECADE. BUT THERE COMES A POINT AT WHICH EFFICIENCIES CANNOT MAKE UP FOR LACK OF MANPOWER. WE ARE PROUD OF THE EFFICIENT OPERATON OF CUSTOMS IN THE SEATTLE DISTRICT, AND PROUD OF OUR RELATIONSHIP WITH OUR DISTRICT DIRECTOR, ROBERT HARDY. BUT CUSTOMS NEEDS MORE PEOPLE TO DO THEIR JOB IN SEATTLE. WE NEED YOUR HELP TO INCREASE THE RESOURCE LEVELS IN THE SEATTLE DISTRICT. WE SINCERELY HOPE THAT YOU WILL BE ABLE TO ASSIST US IN ADDRESSING THIS VITAL NEED.

THANK YOU, MR CHAIRMAN.

44-565 O-85-27

STATEMENT OF JOE FAKER, COMMISSIONER, PORT OF TACOMA

My name is Joe Faker. I am a member of the Port of Tacoma Commission and I very much appreciate your giving me this opportunity to address this vital matter of customs service. I know our time is limited here and I will keep my remarks focused on the specific needs of the Port of Tacoma. A fuller examination of this issue has been made available to you in written form.

I worked as a longshoreman for 20 years on the Tacoma waterfront. I doubt there is anyone prouder of the fact that the Port of Tacoma is the fastest-growing port in North America. That growth is tied to the shift of trade volume from the East Coast to the West Coast. In 1983, there was 24 percent more trade between the United States and Asia than there was between the U.S. and Europe.

That growth is a direct result of a tremendous commitment the Port has made to develop its facilities and attract major shipping lines. We have spent over $50 million in the past two years for larger terminals, newer railyards and the most advanced equipment. In less than a month, Sea-Land, the nation's largest container cargo carrier, will move its operations from Seattle to Tacoma. Two weeks later, Maersk Line, another of the most prestigious shipping lines in the world, will start a new service in Tacoma.

This means that the Port will see more than a 300 percent increase in containerized cargo volume from June, 1985 to June, 1986. At that time, the Port of Tacoma will rank as the sixth busiest container port in North America.

More than 80 percent of the cargo that comes into the Port is headed for destinations inland. If the flow of cargo onto the rail connections is not fast enough, the shippers will be forced to look to other West Coast ports or to use an all-water route to the East Coast.

How can customs impact the cargo flow? If a shipper unloads a container of electronics equipment worth $1 million and it is delayed while awaiting inspection even 24 hours before it can be hauled inland, that represents $274 worth of interest incurred. Multiply that by two, three, or five days delay and the hundreds of thousands of boxes that pass through the Port and you can understand the cost of delays to shippers---and ultimately the customer.

I know you do not have time to wade through a lot of statistics and clever phrases, so I will cut right to the heart of my message. For our concerns here today, we need to look not so much at total container traffic as at the import boxes that have to be serviced by customs.

In the previous 12 months, customs in Tacoma has processed just about 50,000 twenty-foot equivalent (TEU) containers. Without even considering the new shipping lines, this number projects to go up to 55,000 for the next 12 months. Now add the import cargo of Sea-Land. That's 134,000 TEUs. Add Maersk. That's 52,000 TEUs. In the next year, the Port of Tacoma customs staff will have to handle 241,000 TEUs---or nearly a 500 percent increase over the current volume. That's a 500 percent increase.

That customs staff now consists of 11 inspectors. After discussing growth projections with local customs officials, it has been determined that customs needs to add the following: six inspectors, two import specialists, one commodity team aide, and two computer operators.

We have found the local customs officials to be very cooperative and anxious to perform their duties. We hope you will be able to affect allocation of customs officials according to these very pressing needs I have tried to define here this morning. Thank you for your concern.

NATIONAL TREASURY EMPLOYEES UNION

STATEMENT OF ROBERT M. TOBIAS, PRESIDENT

ACCOMPANIED BY:
PAT SMITH
PAUL SOBIASO

Senator ABDNOR. Our next witness is Robert Tobias.

Mr. TOBIAS. Thank you very much. We appreciate this opportunity to testify on the appropriations for two important revenue producing agencies.

With me are Pat Smith and Paul Sobiaso from our office.

The budget that the administration has presented with respect to both the Internal Revenue Service and the U.S. Customs Service for fiscal year 1986 is woefully inadequate.

Before we talk about 1986, I would like to talk briefly about the fiscal year 1985 supplemental budget requests that both agencies currently have on file. OMB, contrary to the will of Congress expressed in last year's continuing resolution, is directing cutbacks that caused them to collect less, certainly not more revenue.

In the Internal Revenue Service, the service reduced overall staffing by 800 positions. Six hundred in the tax area.

In the Customs Service, overtime staffing at land border points have been cut as much as 20 percent. In order to correct these problems, we urge the Senate to approve $33 million for the Internal Revenue Service and $6 million for the U.S. Customs Service over those amounts requested by the agencies in the fiscal year 1985 supplemental budget request. These are the amounts in the fiscal year 1985 pay adjustment which OMB has forced those agencies to absorb. We urge that the money that OMB has forced these agencies to absorb be added in the supplemental by adding $33 million for IRS and $6 million for the Customs Service.

With respect to the U.S. Customs Service's fiscal year 1986 budget request, the administration has proposed a reduction of 887 positions from the current authorized level. In light of the incredible situation which exists concerning our failure to stop the importation of illegal drugs and illegal imports which are flooding this country, the administration's fiscal year 1986 budget is totally unacceptable. This is especially true when you look at the fact that there is a $40 billion trade gap, 40 billion dollars' worth of goods are coming into this country which should not come in. Only 2 percent of the containers are examined which come into this country. This proposed budget would reduce the number of customs employees to the level employed in 1975, back to 1975.

It is also interesting to note that in 1982 it was estimated that the amount of drugs coming into this country was $85 billion and only 7 percent of the heroin was interdicted, 11 percent of the cocaine, and 10 percent of the marijuana. And in spite of all of these statistics what we see is a request for fewer people, not more.

What we urge is not only that the 887 be restored, but that 650 additional customs personnel be authorized over the current level. Four hundred fifty customs inspectors, 150 import specialists, and 50 patrol officers.

We predict this will cost approximately $30 million. Since currently for every dollar that is invested there is a yield of $20 in revenue collected, we think that it is a sound investment of taxpayers' money in terms of revenue and we think it is a sound investment in terms of attacking the amount of drugs coming into this country.

With respect to the Internal Revenue Service, we would like to show you, if we can, a few charts that we had xeroxed. The first chart shows clearly how OMB has really turned the will of Congress on its head. You can see it very clearly with the solid line at the top which shows the number of positions appropriated and at the bottom, the number of positions realized. So that you can see, from 1980 to 1985, that we are at about the same number of positions authorized, but the number of positions realized is significantly less. That gap is incredible. You can see 90,000 were authorized in 1983 but only 83,000 positions were realized. It certainly is not—there is not any reason why we see this OMB not following the will of Congress and we would urge you this year, Senator, to mandate that the positions be filled as opposed to allowing OMB to override what I believe is the legitimate concern of the Congress to appropriate positions for revenue producing agencies.

The second chart shows the returns processing. This is the place where there has been a great deal of trouble in the Internal Revenue Service this year. You can see the number of primary returns filed. That is, individual, corporate, and partnership returns has increased by 41 million.

The number of refunds scheduled, an additional 3.1 million this year, 2.3 million next year and at the same time an incredible decrease in the number of staff in the returns processing area, over 5,000 in the last 5 years. We think that is in large part why we have had a real problem in processing returns at 10 servicing centers this year.

Taxpayer service is another area that has had real problems because of lack of proper funding. In 1984, 63 percent of the taxpayers requested assistance and 82 percent received that assistance. In 1985, it is projected again that 63 percent will request assistance but that the fall off will be to 74 percent who will receive it and that will fall to 69 percent in 1986. Clearly, when you compare these charts you can see the reason people are not receiving assistance even though the Tax Code gets ever more complex and the demand for assistance increases over time. We are providing less and less assistance because we have fewer and fewer people answering the phones.

We see the same thing in the examination area. The number of returns is going up, up, and up and up and the number of returns examined is going down and down and down. Also, as a percentage of the total returns filed, going down, down, and down. Next year it is projected, if nothing changes, that we will be at 1.2 percent of returns

audited. That is an historic low in terms of the number of returns audited. We believe that since every dollar spent on a revenue agent brings spent dollars in return, that it is a wise investment. We also believe that it is a wise investment in terms of attacking the tax compliance gap. The Commissioner of the Internal Revenue Service predicts there will be $87 billion, next year, $92 billion in funds owed but not collected. It seems to me we ought to go after that money instead of ignoring it by decreasing the number of people assigned.

We have the same problem in appeals. You can see the number of appeals are increasing. We have $20 billion of unresolved cases in appeals. The average settlement is 19,000 in appeals, and yet, instead of allocating more staff and more positions, what we have is fewer people and the backlog increases.

Finally, in the area of collection, again, we have the number of delinquent accounts leveling off after reaching an all time high in 1983 of $2 million, decreased to $1.7 million. The leveling off, $7.6 billion and a reduction in the number of staff-years in collection. Again, the money is out there. The taxpayers are identified. The amount of money is identified, and yet this administration thinks that it makes financial sense to cut the number of positions in collection. We believe that that approach makes no sense.

What we urge is a restoration of the 1,200 positions that this administration has proposed to cut and an additional 4,000 positions. We believe that the salary cuts for the additional positions and the restoration of the 1,200 would be $174 million but that would yield an additional $2.6 billion in revenue.

Finally, the 5-percent pay cut proposal which OMB has included in all agency budgets. If this money is not added back into the agencies budgets, OMB will once again be able to control staffing levels no matter what the Congress approves.

PREPARED STATEMENT

In summary, we urge that there be a restoration of positions in customs plus 650 positions. We urge that with respect to the IRS, that the reduction of 1,200 be restored, and an additional 4,000 be authorized. We think when we are talking about revenue, it makes sense to fund the agencies at an adequate level.

Thank you.

[The statement follows:]

STATEMENT OF ROBERT M. TOBIAS

INTERNAL REVENUE SERVICE

Mr. Chairman and Members of the Subcommittee: I am Robert M. Tobias, National President of the National Treasury Employees Union. Our union is the exclusive representative of over 120,000 Federal workers, including virtually all employees of the Internal Revenue Service. I am accompanied today by Paul Newton, NTEU Director of Legislation, and Paul Suplizio, legislative consultant.

On behalf of the thousands of dedicated men and women who collect the revenue of the Federal government, I appreciate this opportunity to express our union's views on the Administration's budget request for IRS for Fiscal Year 1986.

The budget submitted by the Administration is a travesty and should be rejected. If approved, it would entail the loss of over a billion dollars in revenue, when the need for revenue is greater than ever; it would lead to further erosion in voluntary compliance, when the need to stem the decline in compliance is paramount; and it would gravely weaken a system of tax administration which is already under great strain.

Approval of this budget would plunge IRS to the lowest performance levels in recent years. Returns Processing will be cut by 3 percent, despite the fact that IRS is coping with 9 million additional returns this year and there will be 5 million more in FY 1986. Signs of strain in the system are already evident, and further cuts would be most unwise. Ironically, the proposed budget will result in 650,000 fewer notices to those who underreport their income, with a resulting revenue loss of $220 million -- more than enough needed to provide for the workload growth.

As is well-known from press accounts, this filing season is not going well for IRS. By March 29, IRS had received 1 percent fewer returns than in 1984, but had processed 26 percent fewer. The number of refunds issued by the end of March was down 29 percent from a year ealier.

The lag between the time a return is received and the refund mailed has increased to eight weeks. There are only seven weeks between April 15 and June 1st, after which IRS must pay interest on refunds. If the rate of processing does not improve in the next few weeks, it will end up costing the government money.

IRS' explanation has focused on the major computer changeover at all Service Centers under the ADP modernization program. Equipment failures have occurred, and the usual amount of bugs have been encountered. Equipment has been a contributing factor, but it is not the primary factor.

Of greater significance is the increase of 9 million returns, coupled with budget cuts in Returns Processing to below levels authorized by Congress. This is what has stretched the system thin.

In the FY 1984 Continuing Resolution, Congress authorized 24,297 average positions for Returns Processing. When OMB got finished with this allowance -- after requiring IRS to absorb substantial pay and other cost increases -- the actual number of positions realized was 21,743, or 2,500 positions fewer than the Congressional Appropriation.

This is the situation that existed in October, 1984 -- just a few months before the onset of the 1985 filing season. IRS was short-changed by 4,200 average positions for returns processing -- the 2,500 mentioned earlier plus 1,700 additional positions needed during the 1985 filing season.

We believe that the responsibility for the shortfalls of this filing season can be laid directly at the door of OMB. Its short-sighted budget policies have drained all reserves out of the returns processing system, eliminating the flexibility needed to cope with unforseen developments such as the extra million in returns growth that occurred this year.

The impact of this short-sightedness is bad enough when the Federal government has to pay interest on taxpayer refunds. But the consequences do not stop there. The increasing complaints of taxpayers about their inability to get through to IRS, the unanswered correspondence and unresolved problems, are a rude jolt to taxpayer confidence in the system.

We must repair the present situation, and repair it fast. Congress should take the lead in doing so, by providing adequate resources for Returns Processing when it considers the FY 1985 Supplemental and FY 1986 budget requests.

If this budget is approved, the total number of examinations would fall for the ninth straight year, and audit coverage would be the lowest in history, 1.2 percent. There would be a loss of $220 million in direct enforcement revenue from exams in FY 1986, coming on top of a loss of $500 million in FY 1985. With the incremental rate of return in Examination now running at $20 per every dollar spent, there is no excuse for this loss.

More Revenue Agents would also help stem the decline in voluntary compliance among taxpayers. Besides the direct enforcement revenue from exams, additional revenue of approximately $8 billion accrues for each one percent increase in the level of voluntary compliance. By helping to raise the level of voluntary compliance, additional audits cause a large amount of revenue to flow to the Treasury.

Last year, IRS revised its estimate of the level of voluntary compliance from 90 percent -- a figure it had been using for years -- to 80 percent, based upon new tax compliance research. This revision is highly significant; it shows there is plenty of room for improvement in the level of compliance. We believe Congress should set as a goal to get this rate back up to 90 percent, by providing the resources needed to increase IRS enforcement programs until this goal is met.

If this budget is approved, the extraordinary backlog of cases in Appeals and docketed before the Tax Court, would rise to astronomical levels -- from 71,000 to 84,000 cases in Appeals, and from 67,000 to 100,000 cases docketed for trial. More than 60 percent of the cases in Appeals, and a third of the docketed cases involve abusive tax shelters, where prompt resolution is essential for fairness to the taxpayer and to curb this type of abuse.

With over 300,000 tax shelter cases still in Examination, the appellate system is overloaded and IRS is now auditing fewer partnership returns. Recently, it dropped its audit coverage of these returns substantially from 2.4 to 1.6 percent. If the logjam in Appeals is not resolved, the promising attack on abusive tax shelters will be jeopardized. IRS should be given the resources to clean up this backlog.

If this budget is approved, 1,300 staff-years will be cut from the collection of taxpayer delinquent accounts, with a resulting revenue foregone of $585 million. With incremental return in Collection running at 19 dollars collected for every dollar spent, and with $7.6 billion in the inventory of active accounts receivable, the Federal government cannot afford to forego this urgently needed revenue.

In FY 1983, after the backlog of past-due tax accounts had gotten out of hand, the Administration launched a revenue initiative in which 3,600 more staff-years were provided for Collection. With this year's budget, all but 400 of those positions are wiped out.

If this budget is approved, some of the 5 million among us who fail to file tax returns will have cause to rejoice, because there will be 185,000 fewer delinquent return investigations and $639 million fewer dollars collected from non-filers than in FY 1984.

If this budget is approved, the number of positions in Taxpayer Service will fall 225 below the level of FY 1984,

despite a Congressional mandate that the FY 1984 level be maintained. As a result, 5 million fewer taxpayers will receive walk-in, correspondence, or toll-free telephone assistance.

The numbers we have recited are not the invention of NTEU. They are spelled out in the budget submission itself, or can be derived directly from the data in that submission. This budget is its own indictment.

It is the Office of Management and Budget's job to ensure that the nation's revenue-raising arm -- an organization which employs 96,000 people and transacts more business than any corporation anywhere else in the world -- is provided with a sensible, business-like plan attuned to the present fiscal crisis. Instead, OMB has come forward with a plan that would result in foregoing a grand total of $1.6 billion in revenue that the Federal government urgently needs. The revenue loss is summarized in Table 1, attached to our statement.

According to our calculations Mr. Chairman -- and these are again based on the budget submission -- it will require $234 million and 2,900 average positions just to restore the IRS program to the level provided by the FY 1985 Continuing Resolution, plus normal workload growth. We consider this amount to be a bedrock minimum requirement for a realistic program in FY 1986. Of the $234 million required, $100 million is to eliminate the 5 percent pay cut proposed for Federal employees, $87 million is to offset program reductions, $33 million is to restore 800 positions cut in FY 1985 through pay absorption, and $ 3 million is to offset so-called productivity savings.

We are not opposed to productivity savings, as NTEU has been in the forefront of efforts to assure a modernized, efficent Service. But we all know that so-called productivity savings are simply OMB's way of disguising program cuts, and we have seen what staff reductions from phony productivity savings have done to the capabilities of our IRS Service Centers in recent years. We believe that,

while productivity savings are inevitable and desirable, any such savings should be re-directed to other programs and not used to cut skilled personnel who are essential to an effective Service.

We also consider it indispensible that the amount required to offset the 5 percent pay cut for Federal employees be restored to each agency's budget this year, rather than through a pay supplemental next year. The reason is that, by requiring absorption of all or part of pay requirement OMB can hold each agency's budget hostage next year. To repeat, funds to restore the 5 percent pay cut should be put back into the budget this year.

NTEU's alternative budget to restore IRS programs to the level of the FY 1985 Continuing Resolution, plus normal workload growth, is contained in Table 2, attached to our statement. The additional revenue that would be generated by adopting this budget -- $1.1 billion in FY 86 and $5.5 billion over the next five years -- is shown in Table 3. You will note that this budget provides only a bare minimum augmentation of staff in various functions: 1,103 positions for Returns Processing, 513 postions for Examination and Appeals, 1,244 positions for Investigation, Collection, and Taxpayer Service.

We believe such a "current service" budget is inappropriate to the challenges facing the nation at this critical jucture. Therefore, we would go further. We recommend advancing the date of the Administration's proposed revenue initiative from FY 1987, when it is now scheduled to begin, to FY 1986.

As you know, the budget contains a proposal to add 2,500 additional Examination positions during the period FY 1987-89, to collect $4.6 billion in additional revenue. Surely, there is little reason to delay implementation of this proposal. The Administration supports the plan, and acknowledges that it is needed. The Congressional Budget Office, in its list of deficit reduction options for FY 1986, has proposed an even larger plan that would add

5,000 average positions for examinations over a five-year period beginning in FY 1986.

We believe Congress should seize the opportunity presented by the Administration and advance the revenue initiative to FY 1986. Doing so would add 2,500 average positions at a cost of $87.5 million to NTEU's budget proposal, bringing our proposal to $321 million and 5,400 positions to be added to the FY 1986 budget request.

Our total budget recommendation for FY 1986 would then be $3.8 billion and 92,000 average positions. We would like to note that IRS requests to OMB in recent years have been for around 94,000 average positons. This is management's own assessment of its resource needs to deal with increased returns processing workload, implementation of new legislative requirements, systems modernization, the tax gap and other compliance programs. Even with the additions we have made, we are still 2,000 positions below the level Mr. Egger has been requesting of OMB.

Table 4, attached to our statement, shows NTEU's recommendation for restoring the FY 1986 budget to the FY 1985 level plus normal workload growth, and advancing the Administration's revenue initiative to FY 1986. Table 5 shows the revenue that would accrue from the NTEU program. All told, the program would yield net revenue of $2.4 billion in FY 1986, and $9.3 billion over the next five years.

What is the alternative to accepting our budget? The alternative is not simply a loss of tax revenue, but continuation of the decline in voluntary compliance. This is serious business. Once people become convinced that its all right to cheat because others do so -- the Yankelovich survey found that one-third of all taxpayers believe this -- public attitudes may become irreversible and this would spell the end of our tax system as we know it. The longer we wait to raise the level of compliance, the greater the danger we run.

Opportunity lies in the fact that, by acting now to raise compliance, large revenues can be claimed that are legally due the Federal government. Last year, the Commerce Department's Bureau of Economic Analysis reviewed IRS's major study of the tax gap -- the difference between taxes voluntarily paid and the amount legally due -- and concluded that unreported income in this country stood at 8 percent of GNP, and was growing at a 14 percent annual rate. This would cause a doubling of unreported income about every five years.

As the IRS's tax gap estimates stop in 1981, we have projected those estimates forward to 1990. Our projections show that the tax gap is now $120 billion a year and rising. As a nation, we stand to lose more than $600 billion dollars in tax revenue over the next five years.

It is true that Congress has given IRS new tools for dealing with compliance problems, and many believe that tax reform would have a favorable impact on voluntary compliance. But to utilize these tools effectively IRS must be given adequate resources, and until tax reform becomes a reality we simply do not know what the impact on compliance will be. We do know that today abusive tax shelters are sheltering as much as $35 billion in income each year, that 2 million taxpayers are now claiming partnership losses on their returns, and that their number is growing.

So the outlook is grim if IRS does not achieve a prudent and realistic budget this year. We are prepared to work with the Congress in fashioning and enacting such a budget.

I would also like to call your attention to the impact on IRS of the Administration's proposed pay supplemental for FY 1985. Of the $66 million required for this year's pay increase, OMB would allow IRS to request only $33 million. The remaining $33 million is to be taken as an 800 position staff reduction from the levels established by Congress in the FY 1985 Continuing Resolution. The loss of these positions is not only unwarranted in view of the

challenges facing the Service, but will entail a revenue loss of at least $400 million. We trust that Congress will restore this $33 million when it considers the FY 1985 pay supplemental.

I would now like to bring to your attention two matters that have been the subject of discussion between IRS and NTEU. IRS' improved automation capabilities make possible the statistical measurement of performance against program objectives. We have no objection to using statistics to measure the performance of an organizational unit, but we strongly object to applying this system to individuals. The reason is that it is unwise to have employees subject to performance measures that do not reflect differences in individual situations, and that can readily transalate into quotas and production pressure. Experience shows that this would have a negative effect on the morale and retention of employees, on the quality of work, and on taxpayers.

The second matter relates to protecting IRS employees from potentially dangerous taxpayers. Assaults and threats directed against IRS employees increased from 531 in 1983 to 789 in 1984 -- a 50 percent increase. There has been a sharp rise in such incidents since 1981, and their severity has also increased. A Revenue Officer in Buffalo was shot and killed while making a field call; another in Cleveland suffered multiple gunshot wounds at the hands of a taxpayer during a meeting at an IRS office; in Washington, D.C. a taxpayer was convicted of attempting to murder a Revenue Agent. The Service is responding to this serious situation, but problems remain. A way must be found to protect IRS employees from potentially dangerous taxpayers who enter IRS field offices to meet with a Service representative. The Department of Justice must also move vigorously to prosecute individuals involved in assault, threat, and harassment of IRS employees. We need Congress's assistance in this matter, and we are asking for your help.

I would like to conclude by noting that the Yankelovich public opinion survey I mentioned earlier found that a substantial majority of Americans -- about 60 percent -- believe IRS to be trustworthy, accurate, and staffed by

knowledgeable people. IRS employees can take some satisfaction in this result, knowing that their job is a difficult one and there is a great deal riding on how they perform it. Our voluntary tax compliance system is a great institution and we are not unmindful of our responsibility for preserving it.

The remainder of our statement will discuss the basis for our budgetary recommendations, and the forces shaping workload, resources, and programs in major functional areas of IRS.

Compliance and the Tax Gap

When it comes to providing resources for tax compliance, Congress is in the enviable position of being able to kill two birds with one stone. Additional compliance resources will not only raise revenues directly, but will improve the level of voluntary compliance among taxpayers generally, thereby yielding even more revenue to the Treasury.

This is no unproven theory, as the revenue initiative of FY 1983 conclusively demonstrates. You will recall that two years ago Congress authorized 5,000 additional positions, and made changes in the tax code to improve taxpayer compliance and collection of past-due accounts. The revenue from this initiative is now being realized, and is duly recorded in this year's budget. Here is the estimate of receipts that appears on page 4-7 of the budget: Fiscal Year 1983, $4.7 billion; Fiscal Year 1984, $12.7 billion; Fiscal Year 1985, $10.6 billion; Fiscal Year $1986, $11.1 billion; Fiscal Year 1987, $10.5 billion, Fiscal Year 1988, $9.8 billion. Over the six-year period, 1983-1988, a grand total of $60 billion will have been raised by this revenue initiative at a cost of $900 million over the same six-year period for those 5,000 positions.

These results show the tremendous revenue potential of our tax system when relatively small increments of resources are added to the substantial plant in existence. Where else

in the entire government would an investment of $900 million yield revenues of $60 billion? If Congress had been unwilling to act two years ago, the bulk of these revenues would have been lost. But Congress took determined action, and the wisdom of its decision is unquestionable.

Failure to act to stem the deterioration of tax compliance that has occurred over the past decade would not only lead to large revenues foregone from taxpayers unwilling to pay their fair share, but would lead to further erosion of tax receipts through a "ripple effect" upon honest taxpayers of the perception that all are not paying their fair share. It is the shift of attitudes among taxpayers generally, prompted by recurrent reports of tax shelter abuses, underreporters, and non-filers who play "audit roulette" and get away with it, that poses the greatest threat to our voluntary compliance system.

Mr. William J. Anderson of the General Accounting Office summed up this problem when he told a House Government Operations subcommittee:

> "There is a trend toward contempt and abuse of the system which seriously undermines the basic concept of voluntary compliance on which the system depends. Extensive evidence is available to show that noncompliance among both corporate and individual taxpayers is a serious problem and is getting worse."

Last summer, the Internal Revenue Service completed five years of exhaustive research into the state of taxpayer compliance and noncompliance. Its findings, which are presented in Tables 7, 8, and 9 appended to our testimony, are a report card on the health of our voluntary compliance system.

The IRS study found that the tax gap -- the difference between taxes legally owed and voluntarily paid -- on corporate and individual income was $81.5 billion in 1981. By far the largest component of the tax gap, $52 billion, is attributed to unreported income on returns of individuals. Overstated business expenses and personal

deductions accounted for another $13 billion lost on individual returns, while the corporation tax gap was $6.2 billion.

The study estimated the unreported income of individuals in 1981 to be $250 billion, of which $95 billion was wages and salaries, $58 billion was nonfarm proprietor income and small business corporation income, $20 billion was interest income, $18 billion was capital gains income, and $17 billion was "informal supplier income". Informal suppliers are those engaged in "off-the-books" transactions of the kind associated with the underground economy.

For each component of personal income, the IRS computed "voluntary reporting percentages". This is the percentage of income of both filers and nonfilers that was voluntarily reported. The study found that 94 percent of wages and salaries, 84 percent of dividends, 86 percent of interest, 59 percent of capital gains, 79 percent of nonfarm proprietor and small business corporation income, and 21 percent of informal supplier income was voluntarily reported to IRS in 1981. Overall, 89.3 percent of taxable income was voluntarily reported, compared to 91.2 percent in 1973. There has been a steady decline of about .2 percent a year in voluntary reporting since 1973.

Even more significant is the fact that IRS has had to revise its overall estimate of tax compliance by individuals from a 90 percent compliance level before the study was made to 80 percent thereafter. IRS found the state of individual taxpayer compliance to be much lower than the results it had been getting earlier from its Taxpayer Compliance Measurement Program.

The compliance level is the percentage of taxes voluntarily paid to taxes legally due. While the voluntary reporting percentage shows the amount of income voluntarily reported, there are additional tax losses due to overstated expenses and deductions, which brings the overall compliance level down to 80 percent.

IRS announced this major drop of ten percentage points in individual tax compliance without explanation. Testifying before the Senate Finance Committee on June 23, 1983, the Acting Commissioner of Internal Revenue stated:

> "Despite the magnitude of the problem, I can't emphasize too strongly that most taxpayers are conscientious, and that the tax system is basically sound and reliable. The tax reported voluntarily -- that is, without any enforcement effort -- is approximately 80 percent of what is owed. We should not overlook, however, the fact that this voluntary compliance results largely from a good set of tax administration rules based on witholding and information reporting, and a tradition of effective and fair tax administration."

So the Administration has chosen to downplay a most startling and revealing fact, namely, that individual tax compliance has fallen from the 90-percent to the 80-percent level. We believe that a more realistic assessment is called for in the face of this new evidence. We urge Congress to take the lead in examining the full implications of these findings, which show the tax system to be in a more debilitated condition than was heretofore thought.

NTEU has used the data from the IRS study to project the tax gap to 1990. This projection is shown in Table 6. Our projection assumes continued deterioration in voluntary reporting at the rate of .2 percent a year through 1985, and holding constant thereafter. Our results show that the tax gap will increase from $81.5 billion in 1981 to $170 billion in 1990. The cumulative tax loss for tax years 1985-1989, which correspond roughly to Fiscal Years 1986-1990, would be $746 billion over those five years. This is 63 percent of the $1,181 billion current services deficit projected in the budget for those years.

Recovery of these enormous revenue losses is not only an urgent national need, it is essential to stem the downward trend of noncompliance and insure that everyone in

society pays his fair share of the tax burden. Reversing this downward trend is essential to the survival of our voluntary compliance system.

Prompt action is required to achieve these goals. Congress should:

- Establish a 90 percent overall compliance level as an objective. IRS should be required to report to the Congress annually its progress toward achieving this objective.

- Provide IRS with the resources needed to stem the decline in voluntary compliance among taxpayers generally, and prevent the tax gap from expanding further. This would require incremental increases in audit coverage with a target of 2.0 percent, an increase in the number of Service Center contacts with taxpayers, and continued strong commitment to Taxpayer Service.

- Provide IRS with sufficient resources to deal with specific compliance problems, including abusive tax shelters, income underreporting, delinquent accounts receivable, and offshore tax havens.

In its recent report on deficit-reduction options for FY 1986, the Congressional Budget Office has estimated that audit coverage could be raised from 1.4 percent in FY 1985 to 2.3 percent in FY 1990 for a total cost of $1.6 billion. According to CBO, this would yield net additional revenue of $10.8 billion over the five-year period. CBO's calculations support the view that raising audit coverage would improve taxpayer compliance and generate substantial additional revenues.

The results of the revenue initiative of FY 1983 demonstrate the revenue-generating potential of increased audit coverage. One thousand additional staff-years were provided for the Examination Division under the initiative. The results, according to figures presented in this year's

budget, are $807 million in FY 1983 and $1.0 billion in FY 1984. As the cost of the 1,000 positions was $70 million, this means they produced an incremental yield of $25 for each dollar invested. At this rate of return, how can the Federal government afford not to invest in improved compliance?

Some view increased IRS compliance efforts as an unwarranted intrusion, instead of a means of insuring that all taxpayers pay their fair share. During the 1960's, five percent of tax returns were audited and the public did not consider this too great an intrusion. As recently as 1976, the audit coverage was 2.6 percent. Inadequate compliance resources have reduced this to 1.3 percent today, while at the same time the tax gap has more than tripled from $39 to $120 billion. Too many taxpayers abusing the system are gambling that they won't be caught. The perception that many are cheating and getting away with it contributes to a general decline in voluntary compliance. The root cause of this trend is not that IRS is too intrusive, but that it is not intrusive enough.

The General Accounting Office has made this point succinctly:

> "It is important to keep in mind that IRS' various compliance activities do no more than require citizens to pay those taxes that were properly due in the first place, and that in fact were so paid by most of their number. Effective compliance should not be viewed as representing a special burden to the public at large; rather it is aimed at insuring that all share their fair burden."

A large and growing gap between IRS workload and resources has emerged over the past decade. The deterioration in compliance we are witnessing stems in large measure from the generally inadequate level of resources provided. The total of all returns filed (primary, supplemental, and information documents) increased 63 percent between 1972 and 1983. Individual tax refunds scheduled grew 46 percent during the same period. In

contrast, total IRS obligations in constant 1972 dollars increased only 17 percent, and total staff-years increased 23 percent.

As more people enter the labor force, the number of taxpayers increases and so do the number of tax returns filed. Without changing the tax law, this basic workload is uncontrollable. A growing number of returns must be processed, refunds scheduled, examinations conducted, and accounts collected. The increasing complexity of our tax laws adds to the basic workload by making the processing of returns more time-consuming.

At the same time, compliance problems posed by tax protestors, tax shelters, and the underground economy have risen in magnitude. New missions, such as implementing the Windfall Profit Tax Act, and the Interest and Dividends Tax Compliance Act, have proliferated. Billions of dollars in past-due taxes have accumulated. Offshore tax havens have emerged as a major new challenged.

The disparity between workload and resources that has been accumulating for a dozen of years has plunged the tax administration system to the lowest levels of performance in history. Audit coverage in FY 1985 will be the lowest ever, 1.3 percent. This marks the fifth straight year in which coverage has remained below 2 percent. Because of fewer examinations, additional tax assessments will fall from $14.6 billion in FY 1984 to $14.1 billion in FY 1985, a loss of $.5 billion dollars. The Appeals backlog will rise by an additional seven million cases in FY 1985, and another 6 million in FY 1986. Delinquent returns investigations will be 176,000 fewer this year than in FY 1984 resulting in revenue loss of about $610 million. The number of taxpayer delinquent accounts is increasing at about the same rate as dispositions, causing the inventory of delinquent accounts to remain essentially unchanged at a time when top priority should be given to reducing the backlog in the collection program. The amount of revenue in the active inventory remains at a historically high level, $7.6 billion in FY 1985.

The alternative budget we have presented is only the first step in remedying the cumulative resource deficiencies of the past dozen years. The present situation cannot be reversed overnight. It took us several years to get into our present predicament, and it will require several years of consistent resource augmentation to achieve the levels of tax compliance we seek.

The overall cuts made by OMB, from 89,000 average positions in the FY 1984 Continuing Resolution to 88,000 in FY 1985 and 86,000 in FY 1986 do not make sense in light of the steady growth of workload and deterioration in taxpayer compliance. The General Accounting Office has taken issue with OMB on this score. With respect to an earlier proposed cutback it stated:

> "This ratcheting of staffing levels makes it extremely difficult to develop well-founded plans for acquiring, training, and focusing human resources on the multi-faceted task of administering the tax system. A larger and more consistent level of resources to keep pace with growing demand on the tax system appears in order."

In the remainder of our testimony, we would like to consider the dimensions of the workload-resource imbalance for Examination and Appeals, Collection, Returns Processing, and Taxpayer Service. We will consider the performance levels in these functions under the Administration's budget request and our own alternative budget for Fiscal Year 1986.

Examination and Appeals

Examination and Appeals is the backbone of IRS' efforts to achieve a high degree of voluntary compliance with the tax laws. The willingness of taxpayers to file tax returns, correctly assess their liability, and make timely payment is influenced by their perception that these actions will be required if not done voluntarily. Voluntary compliance is dependent to a significant degree on public confidence that IRS is able to identify noncompliance and will take corrective action.

Publicity given to the underground economy, abusive tax shelters, and other forms of noncompliance can have an adverse effect upon compliance among the general public. A perception is fostered that many are not paying their fair share of taxes. This can create a "ripple effect" among normally honest taxpayers, causing them to cheat because what they have read, seen or heard has convinced them that "everyone" is doing it.

A public opinion survey conducted by Yankelovich, Skelly and White last year bears this out, for a majority believe that the public is cheating on their taxes, and that tax cheating is becoming more prevalent. One in five admitted to cheating on their own returns, while one in three took positions that strongly condoned cheating. The perception that others are cheating and getting away with it can seriously undermine our system of voluntary compliance.

Given the overwhelming evidence of sharply declining compliance and its ruinous impact on the tax system, to complacently accept the 1.2 percent examination rate recommended by the Administration for FY 1986 would be a blueprint for disaster. It would assure continuation of the declining trend in voluntary compliance at the critical moment when we should be moving decisively to prevent any further ripple effect among honest taxpayers.

We have already noted that the revenue initiatve of FY 1983 is yielding revenue at the rate of $25 return for each dollar invested in Examination. Recovering these revenues is essential not only to reducing the Federal government's deficit but to insuring that all taxpayers pay their fair share.

Examination must also deal with special compliance problems of major dimensions, including underreporting, abusive tax shelters, and offshore tax havens.

In the area of underreporting, IRS has chosen to focus on the relatively low compliance levels of sole proprietorships and small business corporations. The most recent study of the tax gap concluded that $58.4 billion in income

from these two sources was not reported in 1981. Altogether 21.3 percent of sole proprietor and small business corporation income went unreported.

This problem was also raised by earlier evidence from the Taxpayer Compliance Measurement Program, which found that compliance among small business taxpayers with adjusted gross incomes under $10,000 fell from 79.2 percent in 1965 to 43.2 percent in 1976. This means that these taxpayers paid only 43 percent of the taxes they owed in 1976.

The GAO subsequently analyzed TCMP data for small corporations, those with assets of up to $1 million, between 1969 and 1978. Compliance for this group dropped almost ten percentage points from 83.1 to 73.3 percent during those years.

In order to attack this problem successfully, IRS will need to refine its tools for identifying tax returns with significant amounts of unreported income. More thorough audits will have to be conducted. IRS states that it is now emphasizing quality audits over quantity. It notes that, as the tax laws have grown more complex, audits are dealing with more complex issues and are taking more time to complete. They are also yielding more revenue.

Examination is also at the forefront of IRS' efforts to deal with abusive tax shelters. These shelters generate, through inflated asset valuations and other devices, deductions and credits far in excess of funds placed at risk. Tax shelter schemes, both legitimate and abusive, are widely publicized and highly visible. As their use increases, public confidence in our tax system falls.

IRS is making some inroads against abusive tax shelters, but not nearly enough progress as necessary. At the end of FY 1982, it had 285,000 tax shelter cases under examination and recovered $1 billion out of an estimated $6 billion in questionable deductions. At the end of Fiscal Year 1983, the backlog of cases increased to 334,549 and IRS recovered $1.8 billion out of approximately $7 billion in

questionable deductions. In FY 1984, the backlog stood at 331,395 and $2.2 billion was recovered on 114,323 cases closed -- an average of $19,240 per return.

IRS estimates that it loses $3.6 billion annually due to illegal tax shelters. Over the four-year period FY '81 to FY '84, the Annual Reports of the Commissioner showed that IRS recovered $5.6 billion of the $14.4 billion potential loss. In other words, the net loss to the Treasury from tax shelters alone for this period was nearly $9 billion.

It is little wonder that the sale of tax shelters is growing by leaps and bounds. The use of shelters is now spreading from upper-bracket to middle-bracket taxpayers. In a recent study, the Joint Committee on Taxation states:

> "A major concern is that the highly visible marketing of tax shelters, and the accompanying belief that the Internal Revenue Service cannot deal with them, may erode taxpayers' confidence in the fairness and effectiveness of the tax system.....The widespread use of tax shelters deprives the system of its claim to fairness and retards the administrative and judicial processes to the point that penalties seem neither certain nor costly....The growth of shelters feeds on itself: As the tax base is eroded, rates must be raised to maintain revenues which in turn increases the demand for tax shelters."

Because most tax shelters are structured as limited partnerships, where income or loss is flowed through and taxed at the partner level, IRS significantly increased its audit coverage of partnership returns in 1983 by 16,000, and raised the audit coverage of those returns from 1.63 to 2.41 percent in a single year. (Audit coverage for individual, partnership, and corporation returns in shown in Table 10.) This additional emphasis has raised assessments, but considering the large backlog of unresolved cases and the fact that audit coverage was again reduced in 1984, it is evident that current resources are totally inadequate to deal with this major problem.

The increased emphasis on partnership returns was accompanied by a sharp drop in the number of corporate returns audited -- 22,000 fewer in 1983 than in 1982. Under the Reagan Administration, audit coverage of corporation returns which stood at 8 percent in 1978, plunged to 2.66 percent last year. We have previously called the attention of Congress to the decline, which can only be stemmed by providing IRS with the necessary resources and directing that a minimum audit coverage for corporations be maintained. Failure to stem the sharp decline in corporate audits will only fuel the perception that the tax policies of this Administration are weighted toward "corporate America" at the expense of the individual taxpayer.

Offshore tax havens are a newly-emerging compliance problem that also requires significantly strengthened examination resources. The practice of sheltering income from U.S. taxes by transferring funds to off-shore tax haven jurisdictions is becoming increasingly widespread. The Commissioner of Internal Revenue told Congress last year:

> "It is clear that billions of dollars in taxes are being lost through these mechanisms and equally clear that narcotics traffickers and other elements of organized crime, illegal tax protesters and promoters of abusive tax shelters, to name just a few, are intimately involved in these transactions."

An article in the Washington Post for March 26, 1984 described a Federal grand jury indictment of the Omni International Corporation and four of its executives for tax fraud associated with shifting corporate income to a subsidiary located in an off-shore tax haven. The government charged that Omni put $16.8 million worth of income on its Bermuda subsidiary's books, but only reported $91,574 of that income on its tax returns.

Money flows related to tax haven transactions are frequently hidden by the secrecy requirements established by foreign jurisdictions. The IRS study of the tax gap completed last year states:

> "Indirect evidence suggests that tax haven funds may have been increasing at extraordinary rates. For example, it has been estimated that between 1968 and 1978, international deposits made by non-bank depositors in banks located in all important tax haven areas increased from $5.3 billion to $88.7 billion, an average rate of growth of 33 percent per year. Since it is more convenient for U.S. taxpayers to use the facilities of banks in the Caribbean Basin (which are in or near the same time zones as the major U.S. money center banks), it is of some interest that between 1970 and 1978, deposits (excluding deposits held by other banks) in Western Hemisphere tax haven banks increased from $2.0 billion to $31.5 billion, an average growth rate of 41 percent per year."

The Chief Counsel of the President's Commission on Organized Crime has stated that, "all too often some banks condone money laundering because the balance sheets draw no distinction between legal and illegal monies." The Bank of Boston recently pleaded guilty to failure to report, as required by law, millions of dollars in cash transactions with foreign banks.

To cope with this problem, IRS has approximately 325 international examiners to handle audits of business operations outside the United States. The majority of these audits involve multinational corporations. However, the spreading use of tax havens requires expanded attention to the operations of individuals, partnerships and trusts. International issues will increasingly become an integral part of many audits. IRS' existing resources are far too small to deal with this problem adequately, and additional resources should provided.

The Applellate Division of IRS is under severe strain from mounting caseloads, largely associated with abusive tax shelters, and backlogged inventories at historic highs. The imbalance between workload and resources which we have described in our testimony is nowhere better illustrated than in Appeals. The Administration requests no increase in Appeals staffing for FY 1986. As a result, the backlog of

unresolved cases will climb from 70,900 at the end of FY 1984 to 84,100 at the end of FY 1986.

This starkly worsening situation is graphically depicted in the following table:

	Caseload Inventory	Unresolved Deficiencies and Penalties
End FY 1981	27,000	
End FY 1982	50,000	$12.2 billion
End FY 1983	62,600	$16.5 billion
End FY 1984	69,200	
End FY 1985	73,500	$20.0 billion
End FY 1986	84,100	

An increase of 300 Appeals Officers as part of the 1983 revenue initiative was expected to reduce the average caseload to 48 cases. However, workload has continued to grow. The average caseload per Appeals Officer has risen sharply from 63 cases at the end of FY 1983 to 71 cases at the end of FY 1985.

At the same time that the Appeals backlog has been growing, so has the backlog of cases docketed before the Tax Court. The inventory of docketed cases stood at 52,700 at the end of FY 1982, will rise to 82,400 at the end of FY 1985, and climb to 99,800 at the end of FY 1986. This condition is bound to have severe repercussions upon the Appellate system. The pressure to keep Tax Court caseloads manageable is resulting in expedited settlements in Appeals, something that NTEU predicted two years ago when the Appellate Division was placed under the Chief Counsel's office.

Appeals' agreement rate on cases docketed before the Tax Court increased from 57.1 percent in 1981 to 84.1 percent in 1983 and 83 percent in 1984. Of nondocketed cases, Appeals settled 85 percent in 1983 and 84 percent in 1984. On tax shelter cases alone, Appeals closed 64 percent more cases in 1984 than in 1983. The agreement rate on tax shelter cases rose from 72 percent to 77 percent. Of the

tax shelter cases closed in 1984, 7,870 were docketed cases in which agreement was reached before trial, an increase of 88 percent over 1983.

The 1983 Annual Report of the Chief Counsel states that the increased number of agreements avoided unnecessary litigation for both taxpayers and the government and resulted in earlier tax collections. It also states that increased settlments of docketed cases reduced the rate of increase in the Tax Court's tax shelter inventory.

The question remains whether the goal of achieving a fair settlement with the taxpayer is being supplanted by the interest of the Chief Counsel in keeping litigation caseloads manageable. Appeals Officers must be given adequate authority over dispute resolution. They are highly-skilled professionals who, by virtue of their years of experience, are among the most technically knowledgeable in the IRS. Their job is to strive for settlements in the best interests of the taxpayer and the government. We fear that in the current situation, the extreme pressure that the administrative and judicial system is under will lead to erosion of the quality of settlements in Appeals.

It is incredible that in these circumstances OMB has not allowed additional resources for Appeals. We believe that a minimum of 100 additional Appeals Officers are required immediately, and that IRS should be given the flexibility to assign additional positions to Appeals out of the 2,500 positions recommended for Examination and Appeals in the revenue initiative contained in our alternative budget.

Revenue Agent Attrition

A major problem limiting the effectiveness of IRS enforcement staff is the high rate of attrition among Revenue Agents and Tax Auditors. In FY 1982, the attrition rate for Revenue Agents was 7.5 percent, and for Tax Auditors 8.6 percent (see Table 11). These figures alone fail to present the full dimensions of an extremely serious problem:

- More experienced Revenue Agents are leaving the Service than inexperienced agents. An IRS study of voluntary separations in FY 1979 showed that losses in GS-9 through GS-13 positions were 63 percent of the total number of Revenue Agent quits that year. The other 37 percent who quit were in grades GS-5 through GS-7.

- The field offices with the highest quit rates of experienced Revenue Agents are located principally in the Sunbelt states of the Southeast and Southwest.

- Inadequate salary is the most important factor in this attrition. An article writtine by Richard Whitmore of the Gannet News Service, entitled, "Best Accountants Leaving IRS for Greener Pastures", states:

  "In the past decade, as the salary gap has widened between IRS and private accounting firms, the normal trickle of revenue agents and executives out of the IRS has turned into a flow. Unlike average workers at the Agriculture Department or the Labor Department, for example, many IRS workers have skills that could bring them a lot of money on the outside -- a raise of $10,000-$20,000 for an average revenue agent....."

- The skill and comppetence of an experienced Revenue Agent makes him a valuable commodity for whom alternative employment opportunities abound. In the article above, Whitmore cites the following case:

  "In 1981, at the age of 31 and earning $35,000, Richard Flowers reached the peak of his IRS career. So, after twelve years with the Philadelphia District Office, Flowers left, looking for ajob in private industry with more potential....Flowers got a good raise and limitless potential working as a tax specialist for a Philadelphia energy company."

- IRS is increasingly unable to compete with the salary scales of the private sector in attracting quality accounting graduates. An IRS study completed in 1981 found that the average starting salary offer to

Bachelor's degree candidates in accounting was $16,728. At the 50th percentile, the salary offer for graduates with a Bachelor's degree in accounting was $16,800. The starting salary offer at the 10th percentile, above which 90 percent of the offers were made, was $15,000. These figures compared to IRS starting offers of $12,266 at GS-5 and $15,193 at GS-7 level. The study concluded that salary is a critical factor in the initial recruitment of quality trainees. "Substandard salaries, all else being equal, will result in substantial number of substandard hires."

- Between FY 1980 and FY 1982, attrition rates declined for both Revenue Agents and Tax Auditors, reflecting some improvement in the situation. However, this was a period of economic recession, and recovery may kindle a resurgence of the outflow. The forces creating the underlying problem -- the drain of talent, inadequate salaries, inability to compete for quality graduates, and declining experience level of the overall workforce, have persisted and worsened.

Unless remedial action is taken, these conditions will seriously impair the effectiveness of the IRS enforcement staff. Symptoms of this have already begun to emerge. William Penick, a senior partner in the accounting firm of Arthur Anderson, is quoted in the Whitmore article as saying:

> "The average agent has less experience, less maturity, and just doesn't have the self-confidence to deal with the issues themselves and work out solutions. The most complex of the tax areas are not black and white and where there are grey areas, you should compromise. The older agent knows from practical experience what makes sense, but the young guys don't have the self-confidence to settle the issues themselves."

Former IRS Commissioner Jerome Kurtz adds:

> "You hear a lot of complaints from sophisticated taxpayers that the quality of the people they deal with does not seem the same....what happens is that frequently the more complex issues are not rasied, or are settled on a less-than-optimum basis. There are still a lot of very good revenue agents out there, but you don't see them coming along at the same rate as you used to."

Congress and the Administration need to address the problem of IRS salary scales being out of line with the private sector in terms of both pay and responsibility. For too long, the Federal government has kept the upper grade of an Internal Revenue Agent at the GS-13 level, despite the tremendous growth in complexity of our tax laws and the degree of accounting sophistication with which returns are prepared. A Revenue Agent's responsibility in auditing a complex return of a corporation or partnership today, and the commensurate skills required, are much greater than a decade ago. In order to overcome the starting salary problem, IRS has already begun to hire Revenue Agents at higher entry grade levels. If experienced agents are to be retained, it is essential that the senior grade level for a revenue Agent be raised to GS-14.

The mismatch in relative pay and responsibility between IRS Revenue Agents and their corporate counterparts is well-known and has existed for some time. Whitmore succinctly summarizes it:

> "The bottom line is this: A relatively inexperienced $25,000-a-year revenue agent sitting across the table from a $60,000-a-year private accountant or comptroller backed up by a $100,000-a-year tax lawyer."

Congress can help to correct this situation by requiring the Administration to immediately raise the level of a senior Internal Revenue Agent to GS-14. Congress

should establish standards for higher grades in appropriate situations. In addition, it should provide additional pay to permit IRS to attract and retain high calibre Revenue Agents and other occupations where the Service is having recruitment and retention difficulties.

At the same time, IRS should be required to formulate and implement, with Congressional support, an Employee Retention Program covering critical occupations where attrition is excessive. The Employee Retention Program should contain measures designed to enhance the attractiveness of the Revenue Agent's job, upgrade professionalism, provide greater career opportunities, and increase recognition of outstanding performance.

Collection

Collection Division is responsible for collecting delinquent tax accounts and obtaining delinquent tax returns after the taxpayer has failed to respond to written notice. Mounting unpaid tax accounts and nonfiling of required returns have been persistent signals of increasing taxpayer noncompliance in recent years.

It is imperative that Collection activities be fair and executed professionally, because such actions can involve the seizure of a taxpayer's business or other assets. Since a seizure effectively shuts a business down, the interest of the government in protecting the revenue and the interests of the taxpayers, many of whom are small businessmen, must be carefully weighed.

As the representative of IRS employees, we wish to reiterate our conviction that seizures do not make sense in many cases. The taxpayer loses his business and the Federal government loses revenue. Seizures should only be used as a last resort -- not as a means of improving statistics on some manager's chart.

In order to deal with more than $20 billion in taxpayer delinquent accounts, Congress added 4,000 new Collection

positions in FY 1983. Despite the fact that 200,000 more delinquent accounts are now being closed each year, it is significant that the active inventory of accounts receivable has remained high (more than 1.7 million accounts) for the past three years. This demonstrates that the 4,000 additional positions Congress provided has been just enough to keep pace with current workload, but has not been adequate to make more than a slight dent in the backlog of accounts receivable. Nevertheless, as a result of proposed cutbacks in FY 1986, all but 400 of the 4,000 positions would be eliminated.

The existence of this backlog of 1.7 million delinquent taxpayer accounts, containing $7.6 billion in revenue, shows that there is ample opportunity to collect additional revenue and strengthen compliance by providing additional Collection resources. Such resources would yield a return of $19 or more for each dollar spent.

In past budgets, IRS has stated that productivity savings from implementation of the Automated Collection System -- about 1,700 positions -- would be applied to other Collection functions, thereby generating more revenue. That has not been the case, however. Instead, the Administration has applied the saving to reduce Collection staffing by 1,500 positions (200 in FY 1984, 500 in FY 1985 and 800 in FY 1986).

We believe it would have been far wiser for IRS to adhere to its original plan of keeping the Collection staffing level the same, and increasing Collection programs by 1,500 staff-years. If it had done so, it would have been able to collect an additional 1.2 billion (see Table 1).

NTEU's alternative budget would add an additional 1,000 positions for Collection, enabling 212,000 more taxpayer delinquent accounts to be closed. This would result in collecting an additional $360 million. More importantly, the backlog in taxpayer delinquent accounts would be reduced. In addition, 84,000 more delinquent returns investigations would be closed, resulting in $257 million -- for a total revenue gain of $617 million.

A high rate of attrition among Revenue Officers is preventing IRS from achieving maximum effectiveness in this important enforcement area. The same factor alluded to earlier -- inadequate pay and alternative employment opportunities -- have contributed to this situation.

As discussed earlier in our statement, IRS should implement an Employee Retention Program for Revenue Officers and other critical occupations which are experiencing high turnover. Among the steps that should be taken with the assistance of Congress are a review of pay differentials with the private sector, and increased salary scales to insure that IRS has the ability to compete for qualified individuals in the marketplace. It is essential that the high turnover of Collection personnel in many IRS districts be reduced by comprehensive steps to improve pay, work conditions, and other factors that bear strongly on employee retention.

Assaults and Threats Against IRS Employees

We would like to bring to the attention of Congress the problem of increased danger to IRS employees from threats and assaults stemming from the performance of their duty. The number of assaults and threats rose from 485 in 1982 to 789 in 1984, a 63 percent increase in two years.

We would like to stress our firm conviction that the vast majority of taxpayers are patient and understanding in their relations with IRS. The problem of assaults and threats is confined to a relatively small number of individuals. Nevertheless, because enforcement action can be perceived by some persons as unjust or a threat to their well-being or lifestyle, IRS employees must be constantly alert to the risk of possible assault, retaliation, or harrassment to themselves and their families.

The problem is particularly acute in the Collection area where Revenue Officers are involved in direct enforcement action, such as seizure of a business or attachment of assets. It has been standard Collection

procedure for many years for Revenue Officers to work in pairs in making seizures and to arrange for Criminal Investigation or local police escorts when necessry. Since 1970, Collection has designated High Assault Risk Areas and allowed Revenue Officers to work in pairs in these areas.

Revenue Officers receive training on how to recognize and react to threatening situations that may arise in the performance of their enforcement duties, and what to do if an assault or threat occurs. The training helps to make employees aware of behavior or actions on their part which can contribute to the development of potentially dangerous situations.

Collection has also established an Assault and Threat Reporting System, which requires employees to report all assaults, threats and harassment incidents for investigation by Inspection Branch and follow-up action to provide necessary protection. Analysis of this data for 1981-1984 has revealed that both the number of total incidents and the number of assaults has increased dramatically in the last three years. Analysis also indicates that there is a growing number of taxpayers who are openly hostile to Service employees.

These findings document how more dangerous and stressful the Revenue Officer occupation has become in recent years. Recent shootings of Revenue Officers in Buffalo and Cleveland show how serious the situation is. The hazards and stresses of the occupation are not unlike those experienced by law enforcement personnel, and NTEU believes Congress should consider establishing special retirement for Revenue Officers similar to that provided for law enforcement personnel.

We also strongly urge Congress to impress upon the Department of Justice the necessity for vigorous prosection of individuals involved in assault, threat, and harassment incidents against IRS employees. Prosecution is an important deterrent that is indispensable to the protection

of Revenue Officers, and these employees have the right to expect such support from their government.

Returns Processing

The ten IRS Service Centers will be required to process 179 million primary returns and supplemental documents in FY 1986, an increase of 5 million over 1985 and 14 million in two years. Individual tax refunds will be scheduled for 2.3 million more taxpayers than in 1985, an increase of 5.4 million in two years. The Information Returns Program will have to process approximately 22 million discrepancies involving unreported income.

As is well-known from press accounts, this filing season is not going well for IRS. By March 29, IRS had received 1 percent fewer returns than in 1984, but had processed 26 percent fewer. The number of refunds issued by the end of March was down 29 percent from a year ealier. The lag between the time a return is received and the refund mailed has increased to eight weeks. There are only seven weeks between April 15 and June 1st, after which IRS must pay interest on refunds. If the rate of processing does not improve in the next few weeks, it will end up costing the government money.

Nationwide, 58 percent of returns received at all Service Centers had been processed by the end of March, compared to 77 percent a year earlier. Brookhaven Service Center had processed only 42 percent of returns filed. Philadelphia had processed 42 percent, compared to 79 percent a year earlier. Memphis had processed 65 percent, compared to 81 percent a year ago.

The Philadelphia Service Center is taking ten weeks to process a tax refund -- three weeks longer than last year and twice as long as in 1982.

IRS' explanation has focused on the major computer changeover at all Service Centers under the ADP modernization program. Equipment failures have occurred, and the

usual amount of bugs have been encountered. Equipment has been a contributing factor, but it is not the primary factor.

Of greater significance is the increase of 9 million returns, coupled with budget cuts in Returns Processing to levels below those authorized by Congress. This is what has stretched the system thin.

In the FY 1984 Continuing Resolution, Congress authorized 24,297 average positions for Returns Processing. When OMB got finished with this allowance -- after requiring IRS to absorb substantial pay and other cost increases -- the actual number of positions realized was 21,743, or 2,500 positions fewer than the Congressional Appropriation. This came on top of a similar loss of 6,000 positions in FY 1983, as Table 13 shows.

This is the situation that existed in October, 1984 -- just a few months before the onset of the 1985 filing season. IRS was short-changed by 4,200 average positions for returns processing -- the 2,500 mentioned earlier plus 1,700 additional positions needed during the 1985 filing season (see the FY 1985 budget submission, p.21.) Although the number of Returns Processing positions was raised to 23,111 for FY 1985 -- an increase of 1,400 positions -- the horse was already out of the barn door.

We believe that the responsibility for the shortfalls of this filing season can be laid directly at the door of OMB. Its short-sighted budget policies have drained all reserves out of the returns processing system, eliminating the flexibility needed to cope with unforseen developments such as the extra million in returns growth that occurred this year.

The impact of this short-sightedness is bad enough when the Federal government has to pay interest on taxpayer refunds. But the consequences do not stop there. The increasing complaints of taxpayers about their inability to get through to IRS, the unanswered correspondence and

unresolved problems, are a rude jolt to taxpayer confidence in the system.

We must repair the present situation, and repair it fast. Congress should take the lead in doing so, by providing adequate resources for Returns Processing when it considers the FY 1985 Supplemental and FY 1986 budget requests.

I would like to quote now from our testimony last year, when NTEU warned of the folly of the Administration's budget policy. Unfortunately, it went unheeded.

"According to the budget, these [returns processing] programs will require an increase of 1,758 positions -- 512 positions for document matching to identify underreporters and contain the tax gap, 390 positions to implement the Interest and Dividend Tax Compliance Act, 792 positions for increased workload from processing additional returns and issuing more refunds, and 64 positions for automatic data processing modernization.

"The difficulty with the Administration's budget is that after adding these positions, it cuts 2,868 positions and leaves Returns Processing with a 1,110 position reduction overall. This reduction would be taken entirely in WAE personnel, and full-time permanent positions would not be affected. Regardless of how it is made, a staff-year reduction of this magnitude significantly reduces overall capability.

"The Administration justifies its reduction by claiming 2,446 positions as productivity savings, and making a further unspecified reduction of 244 positions. Of the productivity savings, 1,988 positions are to be saved through unspecified efficiencies. The sole justification in the budget for this huge reduction is a paragraph that reads as follows:

(6) Managerial and Employee Performance -- Efficiencies (1,988 average positions) should be achieved in processing tax returns through efforts at improving employee productivity, assuming continued availability of skilled labor and merit performance.

"We are prepared to be open-minded on the matter of these productivity increases, but without further evidence we remain dubious. Since a cut of this magnitude would wipe out the entire program increase (1,758 positions) deemed to be essential, it jeopardizes IRS' ability to achieve the performance levels it projects in this budget. How can 719 million interest and dividend information returns be processed, and 4.8 million underreproter notices be issued in FY 1985 if this 2,868-position cut is made and the productivity savings do not materialize?

"We believe that it would be unwise to predicate Returns Processing performance, which involves such sensitive matters as issuing refunds and maintaining taxpayers' accounts, on the prospect of achieving so large a saving."

We strongly urge the Subcommittee to approve the NTEU alternative budget for Returns Processing for FY 1986, which restores the cuts made by the Administration and provides the resources requested in the budget for the anticipated growth in the number of primary and information returns filed. We believe these 24,000 average positions to be the minimum resource level required for this important function.

Taxpayer Service

The Administration has again seen fit to flout the intent of Congress and seek a significant reduction of Taxpayer Service, amounting to 225 average positions below the FY 1984 level, which Congress directed to be maintained. We strongly believe that our tradition of voluntary compliance depends on the taxpayer's willingness and ability to self-assess his tax and file a return, and Taxpayer Service contributes importantly to this end.

Moreover, the increasing complexity of the tax code has led to a steady growth in the number of taxpayers requesting IRS assistance. This is shown in Table 14. Whereas in 1976 the number of taxpayers requesting IRS assistace was 52 percent of the number filing individual returns, by 1984 the proportion had risen to 63 percent.

We estimate that by FY 1986, 66 million taxpayers will request IRS assistance, mainly through the toll-free telephone system, but also through correspondence and walk-in service. Of this number, 45.3 million or 69 percent will be assisted if the Administration's budget is approved. This will be the lowest percentage assisted in a decade, as Table 14 shows.

Additional resources are clearly required to curb this decline, but the Administration's budget fails to provide them.

NTEU's alternative budget would provide 260 additional positions for Taxpayer Service, at a cost of $8.6 million. This would permit assisting 50 million taxpayers, 5 million more than in the Administration's program. Under NTEU's program, the percentage of taxpayers assisted would be 76 percent - the same level as the current fiscal year. This means that IRS would help three out of every four taxpayers requesting assistance. As the Taxpayer Service system is under severe strain, we believe this is the lowest service level that we can safely tolerate.

We strongly urge the Congress to approve the additional 260 positions for Taxpayer Service. We must recognize that the demand for taxpayer service is rising as the complexity of the tax code increases and tax law changes are made more frequently. We believe that helping three out of four taxpayers requesting assistance is the minimum service level that IRS should strive for. This cannot be achieved without additional resources, and we look to Congress to provide these funds.

Conclusion

In conclusion, Mr. Chairman, we strongly urge Congress to approve a budget which substantially increases the resources available to IRS in FY 1986. The minimum increase that should be considered, if we are to maintain FY 1985 program levels and accomodate normal workload growth, is NTEU's recommendation for 2,860 additional staff-years and $233.8 million. This would raise $1.1 billion in FY 1986, and $5.5 billion over the period FY '85-'89, over the revenue that would accrue under the Administration's budget request. However, NTEU would go farther and advance the Administration's proposed 2500 position revenue initiative from FY 1987-89 to FY 1986-88. This would raise an additional $1.5 billion in FY 1986 and $4.6 billion over the three-year term of the program. To achieve this, we recommend approval of NTEU's alternative budget for FY 1986, for $3.8 billion and 92,000 average positions (Table 4).

Congress has a rare opportunity not only to reverse the trend of deteriorating voluntary compliance, but to raise significant revenues during a time of crisis in the Federal budget. The enormous size of the tax compliance gap means that additional revenues can be rapidly obtained. The success of the revenue initiative of two years ago bears this out. Both the Congressional Budget Office and the General Accounting Office, chief advisors to the Congress in these matters, have emphasized the revenue yield to be gained when relatively small increments of resources are added to the tremendous plant already in existence.

In closing, allow me to pay tribute to the thousands of men and women who collect the revenue of the Federal government. They maintain, with skill and devotion, the integrity of one of our most vital instituions. Recently, you may have read about the results of the Yankelovich Public Opinion Survey which IRS commissioned last year. It found tht a substantial majority of the American people -- about 60 percent -- believe IRS to be trustworthy, accurate, and staffed by knowledgeable people. The dedicated employees of IRS have worked hard to earn this trust, and I

can assure you they will continue to strive for even higher levels of service to the American taxpayer.

Mr. Chairman, I appreciate the opportunity to appear before you today. I am prepared to answer any questions you may have.

APPENDIX A

Methodology for NTEU's Revenue and Cost Calculations

NTEU's revenue and cost calculations are based upon data contained in the IRS budget submission.

Examination. NTEU's methodology relates additional staff-years to additional exams, and additional exams to additional revenue, based upon data at pages 38-39 of the budget submission. FY86 projected data is used to make the computation, and this is subsequently checked using FY84 actual data.

(1) To compute the impact of 400 additional staff-years, add 400 to 18,112 revenue agents and tax auditors for FY86. Using simple proportion, if 18,112 staff-years yield 1,373,000 exams, then 18,512 will yield 1,403,000 exams, or 30,000 more.

(2) Again, if 1,373,000 exams yield $14.0 billion in revenue, then 1,403,000 will yield $14.3 billion, or $300 million more.

(3) If 30,000 additional exams produce $300 million, the average return is $10,000 per exam in FY86. Using FY84 (actual) data, 1,418,000 exams yielded $14.2 billion in additional assessments (taxes, penalties, and interest) or, $10,000 per exam.

(4) To obtain an estimate of the incremental return at the present level of operation, note that p.37 of the submission states that the FY82-84 revenue initiative (1,000 additional staff-years for Examination) yielded $1 billion in additional assessments in FY84. The cost

of 1,000 staff-years, at $35,000 per staff-year, is $35 million, or a 28:1 return. Also, last year's budget stated that $807 million was produced by the initiative in FY83. Over the two-year period, FY83-84, $1.8 billion was generated at a cost of $70 million, for a 25:1 return.

(5) The incremental cost of 400 additional positions in Examination, at $35,000 per staff-year, is $14 million. The incremental revenue computed above is $300 million. The return is 21:1. Since this is less than the incremental return computed above, it is accepted as a reasonable approximation of the return that can be expected at th present level of operation in Examination. An explanation of the relatively high return (net return, after deduction of cost, is 20:1) is that the total number of examinations has been falling for the past 5 years, and IRS has been concentrating its efforts on the more lucrative exams.

(6) IRS' own estimate of incremental return is 20:1. During FY87-90 it plans to add 2,500 positions at a cost of $75 million and generate $1.5 billion a year in revenue, a 20:1 return. See page 6 of the budget.

Collection. The methodology is the same, except that the additional 1,000 staff-years must be applied to the two basic Collection activities, taxpayer delinquent accounts (TDA's), and taxpayer delinquent returns investigation (TDI's) of non-filers. In this case, it was assumed that 800 staff-years would be applied to TDA cases and 200 to TDI cases. Data used are on pages 57-58 of the budget submission.

(1) TDA computation:

$\frac{12,452}{3,299} = \frac{13,252}{x}$ x=3,511 case closures for 800 additional positions

3,511 - 3,299 = 212,000 additional case closures

$\frac{3299}{5609} = \frac{3511}{x}$ x =$5,969

$5,969 - $5,609 = $360 million additional revenue collected from TDA's

(2) TDI computation:

$\frac{3469}{1461} = \frac{3669}{x}$ x =1545 case closures for 200 additional positions

1545 - 1461 = 84,000 additional TDI closures

$\frac{1461}{4466} = \frac{1545}{x}$ x =$4723

$4723 - 4466 = $257 million additional revenue collected from TDI's

(3) FY84 revenue per TDA: $\frac{5159}{3244}$ = $1,590

$1,590 x 212,000 TDA's = $337 million

FY84 revenue per TDI: $\frac{5105}{1646}$ = $3,100

$3,100 x 84,000 TDI's = $260 million

The data projected for FY86 checks with FY84 experience. The return per TDA is somewhat higher in FY86 than in FY84, but this is reasonable in light of improved collection methods.

(4) To obtain an estimate of the incremental return in Collection, note that p.56 of the budget submission states that the FY82-84 revenue initiative (4,000 additional staff-years for Collection) produced an additional $1.9 billion in revenue in FY84. The cost for these positions was $100 million ($25,000 per staff-year in FY84). The incremental return is 19:1.

(5) The incremental cost of 1,000 positions in Collection is $30 million for FY86 ($30,000 per staff-year). The incremental return is $617 million. The return ratio is 20:1, which approximates that achieved in FY84.

Return Processing. Direct revenue yield can be attributed to the Information Returns program. IRP is a single system that operates with staff from Returns Processing, Examination, and Collection, as shown on pages 14-15 of the budget submission. Enhancement of the Return Processing component generates more discrepancy leads, and these are followed up in Examination and Collection.

(1) As the budgetary data shows, the plan is for 263 fewer staff-years in the Returns Processing component in FY86, and the impact of this is 651,000 fewer underreporter notices issued. By restoring these positions and adding 300 additional positions, more leads can be generated and notices issued. This generates additional revenue.

(2) Dividing total revenue by total cost of all IRP positions yields an average return of 13:1 in FY84 and 12:1 in FY86. Thus, 12 times the cost of the 560 additional Returns Processing positions ($16.8 million) yields $202 million in revenue attributable to those positions.

(3) The cost of a Returns Processing staff-year in IRP is $30,000 (derived from page 14). The cost of a non-IRP staff-year is $24,000. The cost of 1,100 staff-years (560 IRP and 540 non-IRP) is computed as follows:

560 x $30,000 = $16.8 million

540 x 24,000 = $13.0 million

Total $29.8 million

Average Staff-Year Costs. Average staff-year costs are derived from budget data contained in the second page of each division budget submission. The average costs used in this study are:

Returns Processing	
IRP Program	$30,000
Other	23,700
Examination	34,480
Collection	26,480
Appeals	44,000
Taxpayer Service	33,000

Comments. Comments on this methodology should be addressed to NTEU.

TABLE 1

REVENUE LOSS RESULTING FROM ADMINISTRATION'S FY86 BUDGET REQUEST FOR IRS

	Revenue Loss[1] (Millions)
Returns Processing	
Fewer Underreporter Notices	220
Examination and Appeals	
Fewer Examinations	200
Collection	
Fewer Taxpayer Delinquent Accounts (TDA's) Closed	585
Fewer Delinquent Returns Secured from Non-Filers	639
TOTAL	1,644

[1]Based on comparison of FY86 level in the budget to FY84 acutal program, except for:

(a) Returns Processing, where the FY85 program is used as the baseline because of the major increase in Information Returns Program resources between FY84 and FY85; and

(b) Taxpayer Delinquent Accounts (TDA's), where the FY85 congressional appropriation is used as a baseline.

TABL.. 2

INTERNAL REVENUE SERVICE FY 1986 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 1985 Appropriation (Continuing Resolution and Supplementals)[1]		FY 1986 Budget Request		Increase (+) or Decrease (-)		NTEU Recommended Addition to Restore to FY85 Level and Provide for Workload Growth [2]		NTEU Recommended Appropriation For FY 1986	
	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.
Salaries & Expenses	107,347	2240	95,932	2071	-11,415	-169			95,932	2071
Processing Tax Returns	989,507	23,187	998,241	22,846	+8734	-341	+72,970	+1103	1,071,211	23,949
Examination & Appeals	1,384,270	35,354	1,375,302	35,456	-8968	+102	+71,047	+513	1,446,349	35,969
Investigation Collection & Taxpayer Service	1,093,474	27,764	1,041,725	26,116	-51,749	-1648	+89,806	+1244	1,131,531	27,360
TOTAL	3,574,598	88,545	3,511,200	86,489	-63,398	-2056	+233,823	+2860	3,745,023	89,349

1. Includes $33 million over the Administration's pay supplemental request for FY 1985, required to restore 802 positions cut by OMB's allowing only 50 percent of the pay requirement ($66 million) to be requested. Since 200 positions would be cut in examination and 500 positions in collection, there would be a loss of $448 million in revenue if the cut were made.

2. Includes restoration of program reductions and 5 percent pay cut for employees, plus allowances in the budget for processing of additional returns, implementation of the Deficit Reduction Act of 1984, and other increases to maintain current levels. Amounts are extracted from page 2 of the Congressional Budget Submission, and do not include non-recurring costs.

TABLE 3

NTEU FY 1986 RECOMMENDATION TO MAINTAIN FY 85 LEVELS,
AND NET REVENUE GENERATED, FY 1986-FY 1990

	Recommended Additions for FY 1986 (Staff-Years)	Cost (Millions)	Additional Revenue Assessed and Collected FY 86 (Millions)	FY 86-90 (Millions)	Cost FY 86-90 (Millions)	Net Increase In Revenue FY 86-90 (Millions)
Processing Tax Returns[1]	+1,100	30.0	202	1,008	150	859
Examination & Appeals [2]	+500[a]	18.4	300	1,500	92	1,408
Collection [3]	+1000	30.0	617	3,085	150	2,935
Taxpayer Service [4]	+260	8.6	-0-	-0-	43	-43
TOTAL	+2,860	87.0	1119	5,593	435	5,159

[a]400 Examination positions costing $14 million and 100 Appeals positions costing $4.4 million.

[1]NTEU would restore a planned reduction of 260 positions in the Information Returns Program, and would add 300 more positions for a total of 560. Remaining positions would be used to process the additional 5 million primary returns anticipated in FY 1986.

[2]NTEU addition would permit 1,403,000 examinations, 30,000 more than the Administration's program. This would provide an overall Examination coverage of 1.23%, instead of 1.20% under the Administration's program. The additional exams would provide additional revenue of $300 million annually. The increase in Appeals would permit reduction of the large Appeals' backlog of shelter cases.

[3]NTEU addition would permit closing 212,000 more taxpayer delinquent accounts than the Administration's program. This would result in collecting 5,969 million, an increase of $360 million. The NTEU addition would also permit closing 84,000 additional delinquent returns investigations of taxpayers who fail to file returns, resulting in $257 million in additional assessments. Total collection revenue of $617 million annually would accrue to the Treasury.

[4]NTEU addition would permit assisting 50 million taxpayers, 5 million more than the Administration's program.

NOTE: Methodology for NTEU's revenue and cost calcuations is described in Appendix A.

INTERNAL REVENUE SERVICE FY 1986 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 1985 Appropriation (Continuing Resolution and Supplementals)[1]		FY 1986 Budget Request		Increase (+) or Decrease (-)		NTEU Recommended Addition to Restore to FY85 Level and Implement Revenue Initiative 2,3		NTEU Recommended Appropriation For FY 1986	
	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.	Amount ($000)	Avg. Psns.
Salaries & Expenses	107,347	2240	95,932	2071	-11,415	-169			95,932	2071
Processing Tax Returns	989,507	23,187	998,241	22,846	+8734	-341	+72,970	+1103	1,071,211	23,949
Examination & Appeals	1,384,270	35,354	1,375,302	35,456	-8968	+102	+158,547	+3013	1,533,849	38,469
Investigation Collection & Taxpayer Service	1,093,474	27,764	1,041,725	26,116	-51,749	-1648	+89,806	+1244	1,131,531	27,360
TOTAL	3,574,598	88,545	3,511,200	86,489	-63,398	-2056	+321,323	+5360	3,832,523	91,849

1. Includes $33 million over the Administration's pay supplemental request for FY 1985, required to restore 802 positions cut by OMB's allowing only 50 percent of the pay requirement ($66 million) to be requested. Since 200 positions would be cut in examination and 500 positions in collection, there would be a loss of $448 million in revenue if the cut were made.

2. Includes restoration of program reductions and 5 percent pay cut for employees, plus allowances in the budget for processing of additional returns, implementation of the Deficit Reduction Act of 1984, and other increases to maintain current levels. Amounts are ex racted from page 2 of the Congressional Budget Submission, and do not include non-recurring costs.

3. The Administration's proposed revenue initiative for FY87-89 would be advanced to FY86. It would add 2,500 positions to Examination for 3 years, and raise $4.6 billion. Estimated cost of the positions is $87.5 million.

TABLE 5

NTEU FY 1986 RECOMMENDATION WITH REVENUE INITIATIVE,
AND NET REVENUE GENERATED, FY 1986-FY 1990

	Recommended Additions for FY 1986 (Staff-Years)	Cost (Millions)	Additional Revenue Assessed and Collected FY 86 (Millions)	FY 86-90 (Millions)	Cost FY 86-90 (Millions)	Net Increase In Revenue FY 86-90 (Millions)
Processing Tax Returns[1]	+1,100	30.0	202	1,008	150	859
Examination & Appeals [2]	+3,000	105.9	1,800	6,100	530	5,570
Collection	+1000	30.5	617	3,085	150	2,935
Taxpayer Service [4]	+260	8.6	-0-	-0-	43	-43
TOTAL	+5,360	174.5	2,619	10,193	873	9,320

[a]2,700 Examination positions and 300 Appeals positions.

[1]NTEU would restore a planned reduction of 260 positions in the Information Returns Program, and would add 300 more positions for a total of 560. Remaining positions would be used to process the additional 5 million primary returns anticipated in FY 1986.

[2]NTEU addition would permit 1,578,000 examinations, 205,000 more than the Administration's program. This would provide an overall Examination coverage of 1.45%, instead of 1.20% under the Administration's program.
The increase in Appeals would permit reduction of the large Appeals' backlog of shelter cases.

[3]NTEU addition would permit closing 212,000 more taxpayer delinquent accounts than the Administration' program. This would result in collecting 5,969 million, an increase of $360 million. The NTEU addition would also permit closing 84,000 additional delinquent returns investigations of taxpayers who fail to file returns, resulting in $257 million in additional assessments. Total collection revenue of $617 million annually would accrue to the Treasury.

[4]NTEU addition would permit assisting 50 million taxpayers, 5 million more than the Administration's program.

NOTE: Methodology for NTEU's revenue and cost calcuations is described in Appendix A.

TABLE 3

TOTAL INCOME TAX GAP AND PROJECTION FOR
1982-1990
(Dollars in Billions)

Tax Year	Personnal Income [1]	Voluntary Reporting Percentage [2]	Individual Unreported Income [3]	Individual Tax Compliance Gap [4]	Total Income Tax Gap [5]	Individual Income Tax Receipts [6]
1976	1,391	90.4	132	32.2	39.2	132
1977	1,538					158
1978	1,722					181
1979	1,944	89.8	195	50.6	62.3	218
1980	2,160					244
1981	2,404	89.3	250	68.5	81.5	286
1982	2,579	89.1	281	76.0	90.0	299
1983	2,744	88.9	305	82.0	98.0	290
1984	3,013	88.7	340	92.0	110.0	296
1985	3,241	88.5	373	101.0	120.0	330
1986	3,483	88.5	401	108.0	129.0	359
1987	3,747	88.5	431	116.0	138.0	393
1988	4,019	88.5	462	125.0	149.0	434
1989	4,312	88.5	496	134.0	160.0	474
1990	4,596	88.5	528	143.0	170.0	505
Annual Percentage Change(1976-1990)	15.4		20.0	22.9	22.2	18.8

1. From Economic Report of the President and Budget of the U.S. Government, FY 1986.
2. IRS concludes voluntary reporting percentage has been declining at 0.2 percent per annum since 1973. This trend is assumed to continue through 1985, and is then held constant.
3. From IRS, "Income Tax Compliance Research", p.9. Individual unreported income = voluntary reporting percentage x personal income.
4. "Income Tax Compliance Research", p.3. 1982-1990 projected based on 27% of individual unreported income.
5. Individual tax gap is approximately .84 of the total income tax gap, including corporate.
6. See footnote 1. 1989 and 1990 projected at 11 percent of personal income.

TABLE 7

Item 1
Income Tax Gap, 1973 - 1981
(Amounts In Billions Of Dollars)

	1973	1976	1979	1981
Legal sector tax gap, total	28.8	39.2	62.3	81.5
Corporation tax gap, total	3.5	4.6	6.4	6.2
Individual tax gap, total	25.3	34.6	55.9	75.3
Individual income tax liability reporting gap, total	23.8	32.2	50.6	68.5
Nonfilers' income tax liability (Net of prepayments and credits)	0.9	1.4	2.0	2.9
Filers' income tax liability:	22.9	30.8	48.6	65.6
Unreported income	17.2	24.2	38.4	52.2
Overstated business expenses	2.1	3.4	4.7	6.3
Overstated personal deductions[1]	3.4	3.0	5.0	6.6
Net math error	0.1	0.2	0.5	0.5
Individual income tax remittance gap, total	1.5	2.4	5.3	6.8
Employer underdeposit of withholding[2]	1.1	0.9	1.8	2.4
Individual balance due after remittance	0.4	1.5	3.5	4.4
Illegal sector tax gap (partial)[3]	2.1 (0.8)	3.4 (1.3)	6.3 (2.2)	9.0 (3.2)

[1]Includes itemized deductions, personal exemptions, and statutory adjustments.

[2]Also includes a small amount for underreported withholding by employees and a small negative amount for underclaimed withholding by individuals.

[3]Includes income from illegal drugs, illegal gambling, and prostitution only. Figures in parentheses are standard errors.

TABLE 8

Item 2
Unreported Legal-Source Income of Individual Filers and Nonfilers, 1973-1981
(In Millions of Dollars)

	1973	1976	1979	1981
Wages and salaries	33,304	46,274	71,076	94,581
Dividends	1,920	3,638	5,528	8,747
Interest	4,440	6,763	11,548	20,479
Capital gains	5,015	9,935	16,283	17,727
Nonfarm proprietor income and small business corporation income (except informal supplier income)	23,906	32,565	47,246	58,400
Farm proprietor income	5,742	4,542	7,832	9,547
Informal supplier income	10,346	12,721	16,995	17,080
Pensions and annuities	3,123	4,067	6,258	8,799
Rents	1,335	2,390	2,711	3,049
Royalties	312	1,088	1,672	2,770
Estate and trust income	487	695	1,140	1,330
State income tax refunds, alimony, and other income	3,990	6,857	6,260	7,166
Total income[1]	93,919	131,535	194,548	249,675

[1] Total may not equal sum of components due to rounding.

TABLE 9

Item 3
Voluntary Reporting Percentages for Individual Filers and Nonfilers, by Source of Income, 1973-1981

	1973	1976	1979	1981
Wages and salaries[1]	95.4	94.9	94.4	93.9
Dividends	90.7	87.1	85.7	83.7
Interest	87.6	88.1	86.3	86.3
Capital gains	75.7	64.3	63.4	59.4
Nonfarm proprietor income and small business corporation income (except informal supplier income)	84.0	82.2	80.7	78.7
Farm proprietor income	88.6	92.6	89.5	88.3
Informal supplier income	20.7	20.7	20.7	20.7
Pensions and annuities[1]	81.5	85.3	85.0	85.2
Rents	94.7	94.0	95.4	95.6
Royalties	74.3	65.6	64.2	61.2
Estate and trust income	82.0	79.2	75.7	76.2
State income tax refunds, alimony, and other income	66.0	55.2	62.3	62.0
Total income	91.2	90.4	89.8	89.3

[1] Before correcting for pensions misreported as wages. After this correction the VRP's affected would be modified as shown below:

Wages and salaries	95.3	94.9	94.4	93.9
Pensions and annuities	83.5	86.9	86.7	86.9

TABLE 10

RETURNS EXAMINED AND AUDIT COVERAGE
FY 1978- FY 1984

	INDIVIDUAL		PARTNERSHIP		CORPORATION	
Fiscal Year	Number Examined	Audit Coverage (%)	Number Examined	Audit Coverage (%)	Number Examined	Audit Coverage (%)
1978	1,845,242	2.16	27,828	2.44	147,340	8.01
1979	1,844,986	2.11	30,474	2.55	142,937	7.44
1980	1,833,858	2.02	23,041	1.79	133,593	6.48
1981	1,644,104	1.77	22,113	1.62	107,363	5.05
1982	1,455,256	1.55	23,084	1.63	107,705	4.73
1983	1,427,660	1.50	36,115	2.41	85,980	3.64
1984	1,215,927	1.27	25,086	1.57	65,803	2.66

TABLE 11

SEPARATION RATES FOR KEY IRS OCCUPATIONS

Fiscal Year	Revenue Agents	Revenue Officers	Tax Auditors
1967	10.4	11.1	12.4
1968	10.4	11.0	11.0
1969	8.9	7.2	7.5
1970	8.6	7.9	9.1
1971	6.8	8.2	12.0
1972	6.6	7.8	10.3
1973	7.8	8.3	10.6
1974	6.4	7.4	11.7
1975	6.4	6.6	9.6
1976	4.7	6.0	7.0
1977	7.5	7.3	9.5
1978	8.6	8.4	10.9
1979	10.5	9.3	10.0
1980	11.6	9.9	11.2
1981	8.1	8.0	8.5
1982	7.5	8.0	8.6

Source: Internal Revenue Service

TABLE 12

INTERNAL REVENUE SERVICE
Employment History
Selected Occupations
(Average Positions)

Fiscal Year	Revenue Agents	Tax Auditors	Revenue Officers	Special Agents	Appeals Officers
1981 Actual	13,272	4,079	5,323	2,751	835
1982 Actual	13,554	3,000	6,020	2,685	821
1983 Actual	13,613	3,821	7,301	2,593	891
1984 Actual	13,405	3,459	7,527	2,790	1,031
1985 Authorized	14,237	3,767	7,408	2,793	1,073
1986 Estimate	14,351	3,761	7,389	2,791	1,090
Change					
Number					
86 over 85	114	-6	-19	-2	17
86 over 81	1,079	-318	2,066	40	255
Percent					
86 over 85	0.80%	-0.16%	-0.26%	-0.07%	1.58%
86 over 81	8.13%	-7.80%	38.81%	1.45%	30.54%

TABLE 13

INTERNAL REVENUE SERVICE
AVERAGE POSITIONS APPROPRIATED VS. ACTUALLY REALIZED
FY 1983-85

Fiscal Year	Appropriated By Congress	Average Positions Realized
Total IRS		
1983	90,364	83,494
1984	89,282	87,508
1985	88,506	87,743
Returns Processing		
1983	26,367	20,533
1984	24,297	21,743
1985	23,187	23,111

Source: IRS Budget Submissions and Budget Briefing for NTEU.

TABLE 14

NUMBER OF TAXPAYERS REQUESTING IRS ASSISTANCE VS.
NUMBER ACTUALLY ASSISTED
FY 1976-1986

FY	(1) Number of Taxpayers Filing Individual Returns (millions)	(2) Number of Taxpayers Requesting IRS Assistance[1] (millions)	(3) Percent Requesting Assistance[2]	(4) Number of Taxpayers Assisted[3] (millions)	(5) Percent Assisted[4]
1976	85.6	45.0	52%	41.9	93%
1977	86.4	47.0	54%	40.2	86%
1978	87.4	44.7	51%	38.0	85%
1979	90.8	48.6	53%	41.0	84%
1980	93.2			43.0	
1981	94.0			44.8	
1982	95.5			47.4	
1983	95.3			47.1	
1984	96.3	60.8	63%	50.1	82%
1985	101.4	63.9	63%	47.6	74%
1986 (Administration proposal)	104.4	65.8	63%	45.3	69%
1986 (NTEU Alternative)	104.4	65.8	63%	50.3	76%

TABLE 14 (Continued)

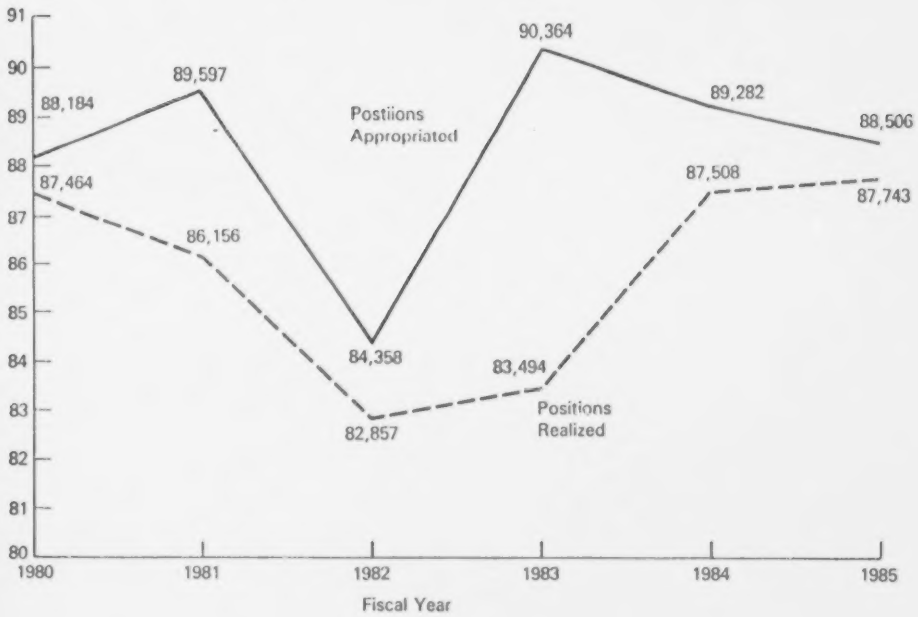
1. This column reflects demand for taxpayer service. It includes IRS' estimate of the actual demand on the toll-free telephone system, not just the number of calls answered. For example, in FY 84 demand was 52 million while calls answered were 41.3 million. Taxpayers seeking walk-in and correspondence assistance are also included. After 1984, the figure is projected by taking 53% of the number of filers.

2. Column 2 as percent of column 1.

3. Source: IRS budget submissions. Data cover toll-free telephone, walk-in, and correspondence. Figures do not include tele-tax or outreach programs.

4. Column 4 as percent of column 2.

INTERNAL REVENUE SERVICE



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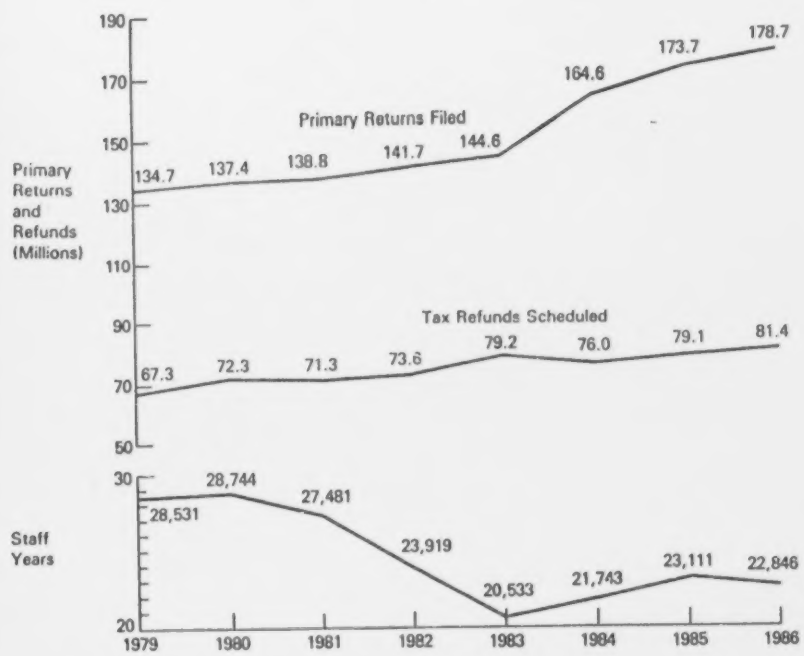
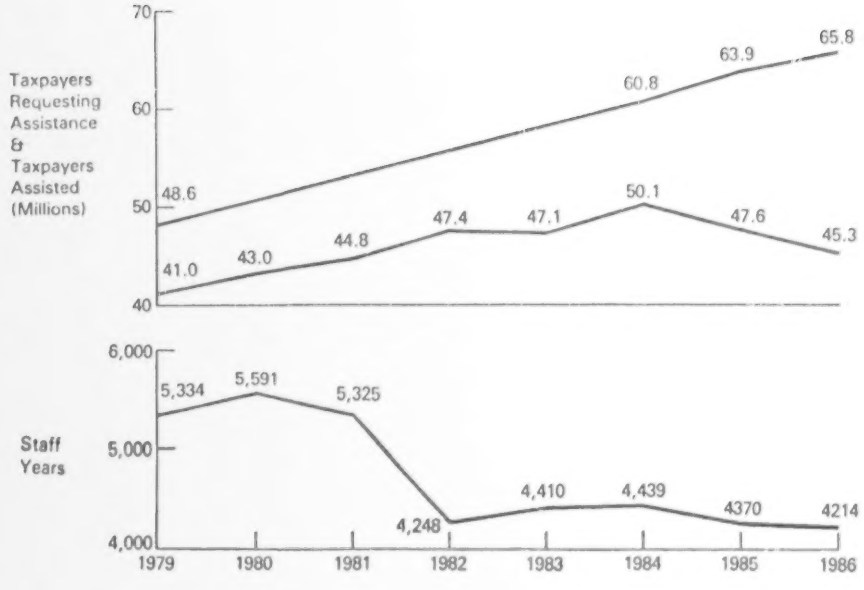


TAXPAYER SERVICE



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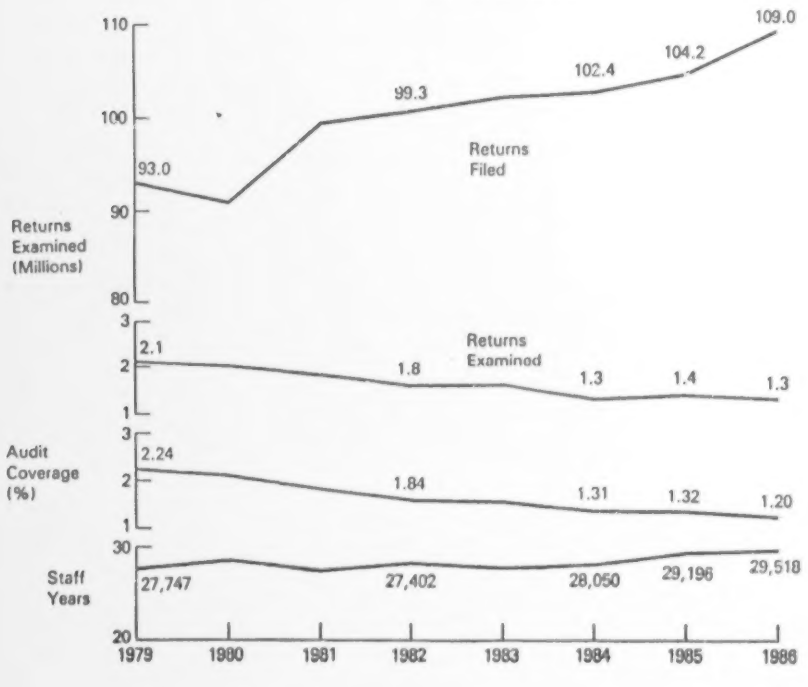
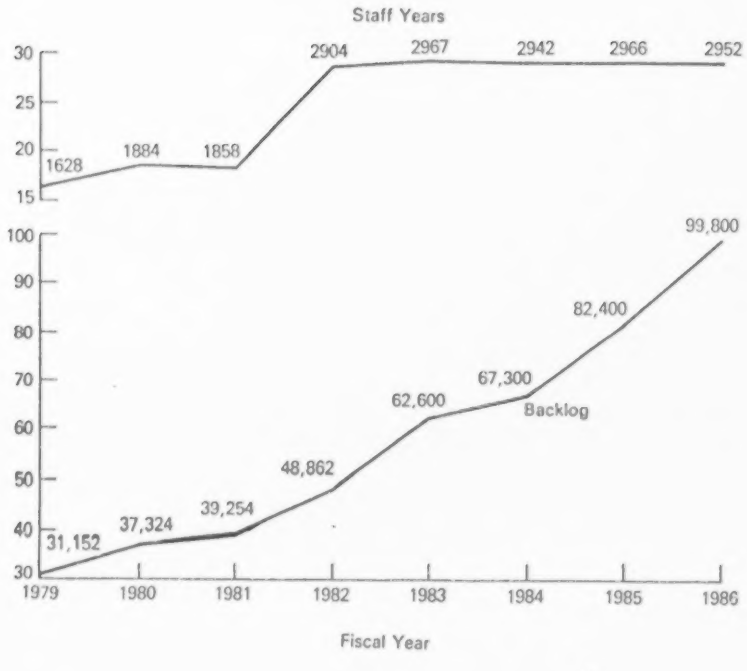
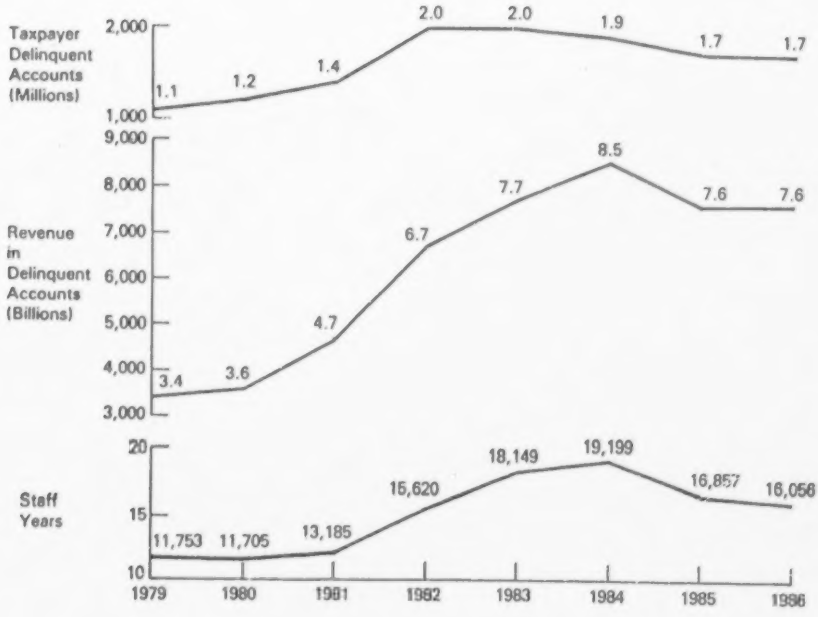


APPEALS



COLLECTION



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REAGAN TAX ADMINISTRATION: A LOSING SCORECARD

	1980	1985	Reagan/OMB Proposal 1986
Total IRS Positions	87,464	87,743	86,489
Returns Filed			
Primary	137.38 Mil.	173.7 Mil.	178.7 Mil.
Information	547 Mil.	968 Mil.	1,046 Mil.
Voluntary Compliance Rate	82.1%	81.7%	81.6%
Income Tax Gap (Money Owed But Not Collected)	$62 Bil.	$87 Bil.	$92 Bil.
Number of Tax Returns Examined	2,179,000	1,454,000	1,373,000
Percentage of Tax Returns Examined	2.1%	1.3%	1.2%
Revenue From Returns Examined	$6.3 Bil.	$14.1 Bil.	$14.4 Bil.
Number of Delinquent Accounts	1.2 Mil.	1.7 Mil.	1.7 Mil.
Uncollected Tax Revenue in Delinquent Accounts	$3.6 Bil.	$7.6 Bil.	$7.6 Bil.
Collected Tax Revenue From Deliquent Accounts	$7.8 Bil.	$22.3 Bil.	$22.7 Bil.
Returns Processing Staff	28,744	23,111	22,846
Direct Taxpayer Assistance Staff	5,591	4,370	4,214

NTEU PLAN - FY 1986

	Amount	Positions
Administration's Budget Request		86,489
NTEU Plan		
Returns Processing	+$ 30,000 Mil.	+ 1,100
Examination and Appeals	+$105,900 Mil.	+ 3,000
Investigation, Collection	+$ 30,500 Mil.	+ 1,000
Taxpayer Service	+$ 8,600 Mil.	+ 260
NTEU Budget Recommendation		
Additional Staff over 1985 Authorized Level - Total Additional Cost	+$174,500 Mil.	+ 5,360
		91,849

ADDITIONAL ASSESSMENTS/COLLECTIONS FROM NTEU PLAN

	FY '86	FY '86-'90
Examinations and Appeals	$ 1.8 Bil.	$ 6.100 Bil.
Collection	.617 Bil.	3.085 Bil.
Information Returns Program	.202 Bil.	1.008 Bil.
Total	$ 2.619 Bil.	$10.193 Bil.

COMPARISON OF NTEU PLAN
WITH REAGAN/OMB PLAN FOR
FISCAL YEAR 1986

	Reagan/OMB Plan	NTEU Plan
STAFFING:		
Returns Processing Staff	22,846	23,949
Examination and Appeals	35,456	38,469
Investigation and Collection	21,902	22,880
Direct Taxpayer Assistance Staff	4,214	4,474
Total Positions	86,489	91,849

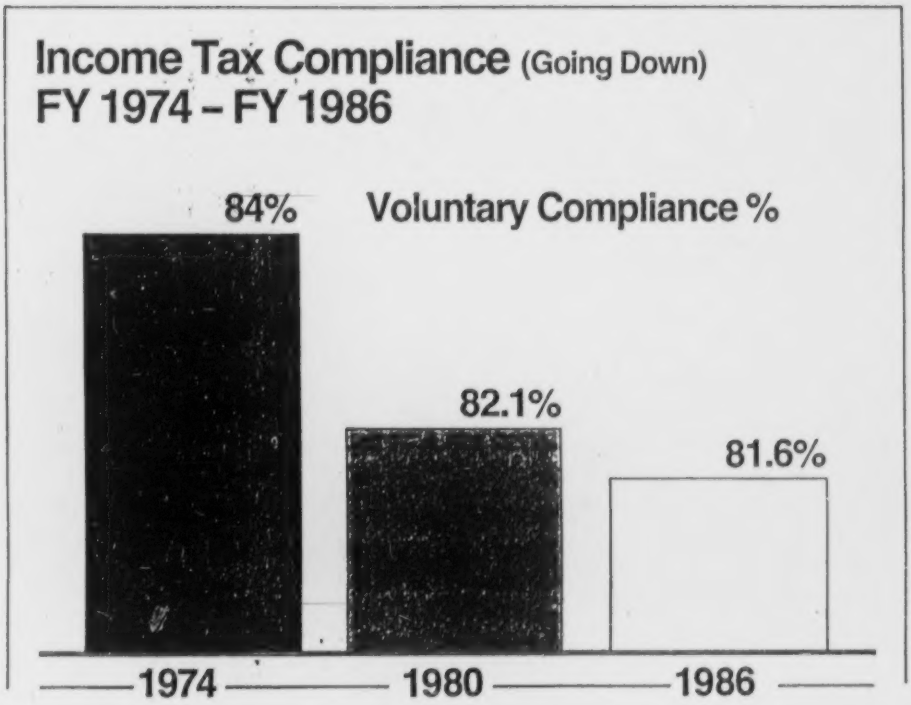
	Reagan/OMB Plan For Revenue Collection	NTEU Plan for Revenue Collection
Number of Tax Returns Examined	1,373,000	1,578,000
Percentage of Tax Returns Examined	1.2%	1.38%
Revenue from Returns Examined	14.4 Bil.	16.2 Bil.
Collected Tax Revenue from Delinquent Accounts	22.7 Bil.	23.3 Bil.
Revenue from Other Sources Including Information Returns Processing	2.0 Bil.	2.2 Bil.
TOTAL REVENUE	39.1 Bil.	41.7 Bil.

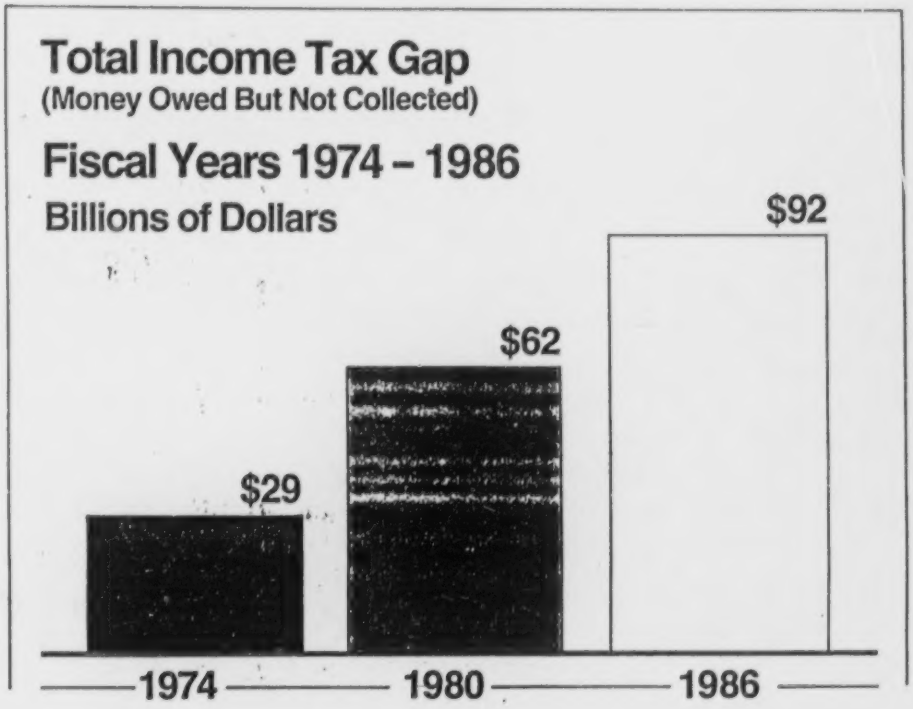
IRS TOTAL POSITIONS

1980	87,464
1981	86,156
1982	82,857
1983	83,494
1984	87,508
1985	87,743
1986	86,489 (Reagan/OMB Proposal)
1986	+5,360 NTEU Proposal 91,849

TAX RETURNS FILED
(In Thousands)

	Primary	Information
1980	137,382	547,000
1981	138,763	645,000
1982	162,814	664,000
1983	171,174	678,000
1984	164,626	692,000
1985	173,743	968,000
1986	178,732	1,046,000


Income Tax Compliance (Going Down)
FY 1974 – FY 1986
84%
Voluntary Compliance %
82.1%
81.6%
1974
1980
1986


Total Income Tax Gap
(Money Owed But Not Collected)
Fiscal Years 1974 – 1986
Billions of Dollars
$92
$62
$29
1974
1980
1986

EXAMINATION OF TAX RETURNS

	Number of Examined Tax Returns	Percentage of Tax Returns Examined	
1980	2,179,000	2.1%	
1981	1,930,000	1.84%	
1982	1,731,000	1.63%	
1983	1,676,000	1.56%	
1984	1,418,000	1.31%	
1985	1,454,000	1.32%	
1986	1,373,000	1.20%	Reagan/OMB Proposal
1986	1,578,000	1.38%	NTEU Proposal

NUMBER OF DELINQUENT ACCOUNTS
(Millions)

1980	1.2	
1981	1.4	
1982	2.0	
1983	2.0	
1984	1.9	
1985	1.7	
1986	1.7	Reagan/OMB Proposal
1986	1.5	NTEU Proposal

UNCOLLECTED TAX REVENUE IN DELINQUENT ACCOUNTS
(Billions of Dollars)

1980	3.6
1981	4.7
1982	6.7
1983	7.7
1984	8.5
1985	7.6
1986	7.6 Reagan/OMB Proposal
1986	7.2 NTEU Proposal

RETURNS PROCESSING POSITIONS

1980	28,744
1981	27,481
1982	23,919
1983	20,533
1984	21,743
1985	23,111
1986	22,846 Reagan/OMB Proposal
1986	+1,103 NTEU Proposal 23,949 Total

DIRECT TAXPAYER ASSISTANCE STAFF

1980	5,591
1981	5,325
1982	4,248
1983	4,410
1984	4,439
1985	4,370
1986	4,214 Reagan/OMB Proposal
1986	+ 260 NTEU Proposal 4,474 Total

EXAMINATION AND APPEALS POSITIONS

1980	30,254
1981	29,260
1982	31,021
1983	30,605
1984	31,549
1985	32,749
1986	33,055 Reagan/OMB Proposal
1986	+3,013 NTEU Proposal 36,068

TABLE 4

U.S. CUSTOMS SERVICE
Average Positions
by Category
FY 1972 - 1986

Fiscal Year	Inspectors	Import Specialists	Patrol Officers	Agents	Total Customs
1972	3,184	1,312	485	853	11,116
1973	3,472	1,304	736	956	11,772
1974	3,693	1,208	971	532	11,878
1975	3,803	1,262	1,152	582	13,076
1976	3,873	1,256	1,191	614	13,380
1977	3,943	1,204	1,365	603	13,228
1978	4,077	1,207	1,251	600	13,854
1979	4,174	1,236	1,211	577	14,061
1980	4,165	1,219	1,231	604	13,820
1981	4,379	1,165	1,332	597	13,316
1982	3,987	1,081			12,924
1983	4,122	1,027	1,134	701	12,898
1984	4,289	1,042	1,246	932	13,319
1985	4,372	1,023	1,246	1,009	13,418
1986 (ADMIN)	4,166	766	1,246	1,009	12,531
1986 (NTEU)	4,772	1,173	1,296	1,059	14,068

Source: U.S. Customs Service Budgets

U.S. CUSTOMS SERVICE

I am Robert M. Tobias, President of the National Treasury Employees Union. With me are Paul Newton, Director of Legislation and Paul Suplizio, Legislative Consultant to NTEU. As the exclusive representative of over 120,000 Federal workers, including virtually all employees of the U.S. Customs Service worldwide, we are pleased to appear before the subcommittee on International Trade to present our views on the authorization of appropriations for the U.S. Customs Service for Fiscal Year 1986.

A crisis of enforcement, long in the making, confronts Customs today. In 1984, sharply rising narcotics traffic made supplies of illicit drugs more abundant than ever, and a huge trade compliance gap brought $40 billion in illegal imports to our shores.

By all indicators, 1984 was a disasterous year for Federal narcotics interdiction efforts. Heroin purity and availability rose. Cocaine supply increased and its street price fell, encouraging its growing abuse by all income groups. While marijuana use has levelled off and actually declined among young people, over 20 million persons are using marijuana regularly.

Drug seizures are larger than ever, which is a credit to Customs, DEA, Coast Guard, and local law enforcement agencies. But larger seizures are also indicators of greater trafficker activity, which means that deterrence is not working. Cocaine supplies have been increasing at the rate of 30 percent a year, and marijuana at a 7% rate. No more than 10 percent of the cocaine and heroin, and 16 percent of the marijuana supply is being interdicted.

There is abundant evidence of the social costs of this traffic in the crime rate, in the job market, in shools and treatment facilities. When a firm in the State of Washington advertised for 750 workers, it was amazed that half failed a test for marijuana use. Here at home, we learn that Montgomery County high school seniors have a rate of cocaine abuse twice the national average. City Councilman John Ray recently pleaded with D.C. residents to eliminate drug abuse which is, in his words, "a form of genocide in the black community." Last month, the U.S. Supreme Court (in New Jersey v. T.L.O.) gave school officials broad power to search students because, said the Court, drug use and violence in the schools are major social problems.

The confrontation with narcotics traffickers has exploded into open warfare. DEA agent Enrique Camarena was abducted recently in Guadalajara, Mexico. We strongly condemn this outrage, and urge the Federal government to make every

effort to ensure his abductors are brought to justice. The Minister of Justice of Columbia was assassinated by the drug mafia and the State Department has warned Americans traveling to that country of possible violence. The drug lords in Columbia, Bolivia, and Peru are growing record crops and boldly challenging the central government. Mexico's Narcotics Control Directorate lost seven agents last month in clashes with the estimated eighteen major drug trafficking gangs active there. A United Nations panel reported that drug trafficking organizations now threaten the security of some countries.

They and the international terrorists attempting to cross our borders require constant vigilance by Customs Inspectors.

An idea of the dimensions of the drug threat is provided by the Mexican government's raid on a Chihuahua province marijuana depot last November. It resulted in seizure of 9,000 tons of marijuana — an amount equal to the annual output of Columbia, the world's largest producer. Police confiscated dozens of truck trailers and freight containers and arrested more than 11,000 marijuana pickers, packers, and warehouse workers.

A casualty of the resurgent drug trade has been the National Narcotics Border Interdiction System, headed by Vice President Bush. The system consisted of coordinating groups set up in six major cities to better direct the Federal interdiction effort. The difficutly is, as the General Accounting Office has pointed out, a coordinating agency is useless without sufficient assets. The resources of NNBIS are in no way adequate to the task it faces.

Customs Inspectors and Patrol Officers continue to account for a large percentage of total drug interdiction. According to the Select Committee on Narcotics Abuse and Control, Customs Inspectors are responsible for making 57 percent of heroin seizures, 59 percent of cocaine seizures, 70 percent of hashish seizures, and 80 percent of marijuana seizures. Air and Marine Patrols account for large cocaine and marijuana seizures. However, despite recent improvements in the air program, the Government Operations Committee has reported that Customs lacks the operational capability to detect, intercept, and seize drug intruder aircraft on other than a sporadic basis.

In the face of this crisis, the Administration has requested a reduction of 411 positions in Customs drug interdiction functions for FY 1986. Of these, 206 are Inspector positions. This is the fifth consecutive year in which Congress has had to deal with a totally unrealistic budget request from this Administration. Customs drug interdiction resources have remained static since 1975, and what is needed is a significant increase to deal with the threat as it exists today.

If we are to make headway against traffickers who have demonstrated enormous versatility in shifting their operations from point to point along our 26,000 mile frontier to avoid detection, there is a critical need for additional Inspectors to deter traffickers from smuggling drugs by means of couriers and cargo shipments. This would leave direct air and sea movement as the sole means of border penetration, and traffickers would be vulnerable to our defenses in these areas provided we ensure adequate interdiction capability. At present, trafficking is so extensive and we are so lacking in Inspectors, and in air and marine capability, that the five Gulf Coast governors have called for turning the drug interdiction mission over to the Department of Defense.

We believe that a single agency should have charge of the nation's borders, and that agency should be Customs. We assume the Cabinet Council on Management and Administration will renew its proposal for consolidation of primary inspection responsibility at air and sea ports in Customs and at land border ports in INS. We strongly object to the fragmentation of narcotics enforcement by assigning primary inspection responsibility at land border ports to INS. Customs already fills a majority of the positions at those ports, and we believe INS lacks the ability to perform the drug enforcement mission. We urge the Subcommittee to move for immediate consolidation under Customs at air and sea ports, while maintaining the status quo at land borders until the air/sea consolidation can be evaluated. We believe the merit of having a single enforcement communications system applicable to all persons regardless of mode of arrival will clearly demonstrate the effectiveness of consolidation within Customs at land border ports.

A second aspect of the enforcement crisis we face is the commercial trade compliance gap, representing nearly $40 billion in unreported and counterfeit goods illegally entering the country, including goods such as steel and textiles entering in violation of specific trade agreements. This compliance gap poses an enormous burden of illegal and unfair competition upon American producers, costing an estimated one million jobs and $3 billion in lost revenue from duties.

The largest part of the compliance gap, $25 billion or 65 percent of the total, consists of unreported goods that go undetected due to insufficient cargo processing staff. Vehicles, vessels, and containers of all types are capable of carrying unreported goods. Another $12 billion or 31 percent consists of counterfeit products. In hearings last year, the House Energy and Commerce Committee exposed the grave danger, both to the economy and to the health and safety of our citizens, of phony drugs, aircraft parts, and other goods of inferior quality parading under an accepted brand name.

With merchandise entries soaring twenty percent last year as the nation recorded the largest trade deficit in its history, Customs (with resources that have remained static since 1975) elected to by-pass 60 percent of the entries, meaning entry documents were not subject to Import Specialist review to ensure proper valuation, tariff classification, and compliance with trade law requirements. In addition, Customs allowed 99 percent of containerized shipments (which comprise 70 percent of seaborne cargo) to enter without inspection. This sharply reduced enforcement placed importers on a virtual honor system, and is one of the principal causes of the trade compliance gap.

Further contributing to the compliance gap were the misguided judgements of Customs management. Unable to cope with the rising volume of entries, Customs has sought to make the honor system its basic principle of commercial clearance. Entries are accepted and duties collected as submitted by brokers, with audits used later to verify compliance. The principle vehicle for accomplishing this is the automated broker interface (ABI), by which brokers'

computers transmit entry data to Custom's computers without Import Specialist review.

We believe this is giving away the store. Customs has documented a long history of significant broker errors: undervaluations and misclassifications that reduce duty and circumvent quota restrictions. This is not surprising because brokers, by tradition and instinct, wish to keep duties as low as possible and there has long been a game of cat and mouse between Customs and brokers. With over 10,000 tariff code classifications, and the possibility of classifying a product in more than one way, the opportunity for self-serving judgements -- unrestrained by any Customs review except post-audit -- would not adequately protect the revenue. Moreover, many tariff classifications can only be properly determined by laboratory analysis, and this cannot be accomplished with integrity after a shipment has entered the stream of commerce.

Last year, correction of broker errors through change liquidations alone resulted in collection of $180 million in additional revenue. Correction of errors through pre-entry review of entry documents generates another $50 million. Broker errors are obviously not insignificant.

If a shipment is classified to get around a quota, the damage to the domestic market will have occurred by the time an after-the-fact audit takes place. Import Specialists need to make admissability determinations and sample the shipment before goods enter the stream of commerce. They can detect quota errors and keep out harmful products, such as chemicals and medicines, that could endanger the public if allowed to enter freely. The idea of allowing the importer to be the judge of admissability is an abdication of responsibility by Customs.

It should be clear from the experience with by-pass to date that an honor system won't work. Since by-pass was instituted in FY 1983 the country has been deluged with unreported goods and counterfeits. The signal that something was wrong came from the affected industry, which had to hire its own investigators to convince Customs that it was losing business and jobs. A post-audit system, can't undo the damage from allowing illegal goods to enter the stream of commerce.

Under an honor system there is a reduced need for Import Specialists to review entry documents. Hence Customs has been trying to eliminate the corps of Import Specialists who are the very backbone of commercial trade law enforcement. As a result, Import Specialists are demoralized. Their expertise, acquired from specializing in a single commodity line, enables them to make proper classification, valuation, and admissability decisions. Without such expertise, the Customs Service would not be on a par with brokers and others in the trade. But because Customs lacks a clear concept for use of the Import Specialist, they are now being assigned to more than one commodity line, to "account specialist" roles handling a single importer's diverse array of products, and to commercial fraud roles helping to make commercial fraud cases. Everything, in other words, but the duty of reviewing entries which would ensure proper enforcement of the nation's trade laws.

In addition, Customs wishes to centralize and reduce the number of duty assessment locations, an action which would eliminate the Import Specialist's services at many ports and cut him off from the trade from which he derives his expertise.

We believe that Customs management has embarked on a misguided and ruinous course in commercial trade law enforcement, with the by-pass system, automated broker interface, and the new Import Specialist policies. We urge this Subcommittee to intervene to re-establish enforcement on the basis of Import Specialist review of entries, and to require that any new system be fully tested, evaluated, and approved by this Subcommittee prior to implementation.

We make the same recommendation with respect to the ACCEPT system for designating shipments to be inspected. ACCEPT is a by-pass system which allows shipments to be released without any inspection whatever. Theoretically, a computer is supposed to designate which shipments are "high risk" and which are "low risk". But in reality, Customs is in the dark about which shipments to inspect, and the decision is best left to the Inspector/Import Specialist team. The Subcommittee should require Customs to suspend implementation of ACCEPT until it has developed far more knowledge of the criteria for identifying "high risk"

shipments, and has tested and evaluated an alternative system.

The Administration's FY 1986 budget request is totally inadequate to the crisis in trade law enforcment that exists today. The Administration requests a reduction of 437 positions in Tariff and Trade functions, including 244 Import Specialists. In the face of a $40 billion compliance gap, we cannot continue to by-pass 60 percent of entries and inspect less than 1 percent of containerized shipments. The urgent need is to add Customs cargo processing positions. This would not only protect U.S. manufacturers from illegal competition, it would also collect a large amount of additional revenue that would help reduce the Federal deficit.

Since 70 percent of entries are dutiable and only 40 percent are now being reviewed by Import Specialists, a large amount of revenue is potentially escaping attention. NTEU has computed that by adding 1,200 more commercial cargo processing positions (consisting of 900 Inspectors, 260 Import Specialists, and 40 Special Agents) to process 975,000 additional entries, $1.1 billion could be collected. The cost of the additional personnel would be $48.4 million. The Inspectors would, of course, perform narcotics interdiction as well as trade enforcement functions.

We recommend that the goal of adding 1,200 positions be achieved over a two-year period. For FY 1986, we recommend the addition of 650 positions over the FY 1985 level, including 400 Inspectors, 150 Import Specialists, 50 Customs Patrol Officers, and 50 Special Agents.

Appended to our testimony are tables that summarize what I have presented today. Tables 1 and 2 provide estimates of the commercial fraud and illicit narcotics threats to this country. Table 3 summarizes our budget recommendations for FY 1986. First, we recommend restoration of the 887 positions cut by the Administration at a cost of $46.6 million. Second, we recommend 650 additional positions at a cost of $30.4 million. The total amount of $77 million and 1,537 positions are added to the President's budget request, yielding our recommended figure of $716 million and 14,068 positions.

The remainder of our statement discusses policy issues in the areas of primary inspection consolidation, cargo processing, overtime, centralization of entry processing locations, and other areas on which the Subcommittee wishes to be kept informed. A summary of NTEU's recommendations is included at the end.

INSPECTION AND CONTROL

Customs/INS Consolidation

The Reagan Administration has announced a major policy decision to consolidate responsibility for primary inspection of incoming persons in the U.S. Customs Service at air and sea ports, and in the Immigration and Naturalization Service at land ports of entry. We know this Subcommittee will play a leading role in giving this proposal careful scrutiny, because of the vital interests affected and the Reagan Administration's apparent inability to referee the competing claims of the Treasury and Justice Departments.

There are many vital interests at stake in the design of an effective primary inspection system. Custom's Inspection and Control mission includes interdicting traffic in drugs, curbing illegal immigration, serving a growing domestic tourism industry, safeguarding American agriculture, controlling the export of critical technology, and enforcing currency controls, endangered species and environmental laws, and many other laws and regulations. Any streamlining of federal inspectional responsibilities must enhance our ability to accomplish these missions to protect our vital interests.

Speaking on behalf of the employees of the U.S. Customs Service, I have no doubt that assignment of primary inspectional responsibility to Customs at air and sea ports is sound and should be approved. A natural evolution in this direction has been underway for some time. The one-stop inspectional system in effect at many ports has required Customs Inspectors to carry out INS functions in processing travelers from abroad. To back up these duties,

Customs has expanded its automated Treasury Enforcement Communications System (TECS). It is also experimenting with passport optical scanning equipment.

Customs Inspectors now outnumber INS Inspectors at all land border ports by 1,100 to 800, and are processing 58 percent of the traffic.

In the Southwest and California, Customs Inspectors and Patrol Officers play a vital role in curbing illegal immigration. Most of the foreign tourist and business traffic, and some of the illegal immigrant traffic flows through cities and land ports of entry. At land ports, all inspectors are one-stop, that is, the requirements of both agencies are enforced by a single Inspector. Customs Inspectors are inspecting millions of pedestrians and vehicles at border crossings each year, performing both Customs and Immigration functions.

We are dismayed at the Administration's failure to assign primary inspection responsibility at land border ports to Customs. We have no doubt that Customs Inspectors can carry out this responsibility, backed up by an INS secondary, as effectively at land border ports as at air and sea ports.

A way the Border Patrol could be provided the increased resources it requires would be for Customs to assume primary inspectional responsibilities at land border ports. The Border Patrol could then concentrate on its primary mission of apprehending illegal aliens between ports of entry, while Customs conducted primary inspection of travelers at the ports themselves.

Indications are that INS is spread too thin to be charged with carrying out the Customs primary inspection mission at land ports. The difficulty the agency has experienced in automating its files, rendering timely services, and coping with foreign students and professionals who come in legally and then overstay their permits, is well-known. According to John Crewdson, who won a Pulitzer prize for his stories on immigration in the New York Times, INS is stretched thin to transparency and stuck in its past. Fairly or unfairly, he calls it "the most Kafka-esque labyrinth thus far devised by government".

It is frequently noted that Customs, as the nation's primary border management agency, has had delegated to it by 40 other government agencies the responsibility for carrying out the laws and regulations of those agencies at the border. Customs has a broad and diverse mission as contrasted to the single mission of INS. We believe it would be far easier to train Customs Inspectors to absorb INS responsibilities at the border, than the reverse.

Transfer of primary inspection responsibilities to INS at land ports would be highly disruptive of major programs such as narcotics interdiction, Exodus, and currency control. It would require 40 different agencies to deal with INS concerning their enforcement requirements, virtually doubling the amount of coordination required since they would have to deal with two agencies rather than one. Such fragmentation of responsibility in border enforcement would not make sense.

Consider the plight of the importing community at all but the largest land ports on our Northern and Southern borders. Responsibility for inspecting commercial cargo transiting these ports would of necessity fall to the local INS port director, who would be required to process merchandise trade now handled by an experienced Customs Inspector - Import Specialist team. Since inspections would be made by INS, and entry documents would go to Customs, the fragmentation of responsibility in processing this trade is apparent.

Customs responds to the requirements of other law enforcement agencies by apprehending fugitives from justice. Each year Customs apprehends more wanted felons than any other law enforcement arm in the country. This is made possible by the training Inspectors receive, and by the modern Treasury Enforcement Communications System (TECS), which accesses the wanted persons, stolen vehicles, and other intelligence of the National Criminal Information Center. TECS permits rapid automatic search of over a million files. By contrast, the INS Lookout Book contains 60,000 manual entries, all of which are in the TECS data base. By training, number of in-place staff, and enforcement support systems, Customs is far better prepared to assume the primary inspection mission at land ports.

It should be remembered, too, that inspection of travelers for immigration purposes is a straightforward procedure. Of the 180 million aliens who present themselves for entry each year, no more than .3 percent are denied permission as a result of border inspection. The dimensions of the illegal immigration problem require much more enforcement capability between ports of entry than at those ports.

Only 12 percent of persons entering the country arrive at air and sea ports, the remaining 88 percent enter through land ports. If real progress is to be made in protecting the vital interests we have outlined, a single agency should have primary responsibility for all ports of entry. Customs' missions is exclusively border management. It is prepared to assume primary responsibility at our land ports, where it is already doing the bulk of the job.

There would be far-reaching benefits to moving to a single border management agency. These benefits would stem from the ability to standardize forms and procedures, and to apply modern technology to border clearance. The passport, visa, I-94 form, and baggage declaration presently used by the two agencies in the inspection process could be consolidated and automated to provide vast gains in facilitation, enforcement, and cost savings.

Combining the I-94 form with the Customs baggage declaration would eliminate millions of forms each year. Airlines could be provided with optical scanning passport terminals which would eliminate the need for their collecting the second copy of the I-94 on the alien's exit from the country. This would be a feasible way of gaining a reasonable degree of control over aliens entering and overstaying their visas or violating the terms of those visas.

In addition, with development of a machine-readable passport the primary Inspector would no longer have to enter a TECS query and primary inspections could be completed more smoothly and efficiently.

The consequence of not consolidating border management in a single agency nationwide is not merely the continuation of costly and redundant systems and paperwork. It means

that government, industry, and the public will not realize the benefits and efficiencies that could be achieved through full consolidation.

Let me outline the Administration's specific plan, so you can better grasp its full dimensions.

At the present time, Customs has 900 positions committed to inspection at air and sea ports, and 1,064 positions at land ports. INS has 719 positions committed to inspection at air and sea ports, and 800 positions at land ports. If the Administration's plan is approved, Customs will absorb all but 214 positions of the INS positions at air and sea ports (including pre-clearance). The 214 positions would be for INS secondary inspections. At land ports, INS would absorb all but 426 Customs positions, which would be used for secondary inspections.

INS would thus gain 638 positions from Customs at land ports. The workload would not change. For the most part, the people doing the work would not change. Essentially, there would be a swap of uniforms.

Customs would similarly gain 442 positions at air and sea ports. Overall, there would be a net loss of 200 positions from Customs to INS, reflecting the fact that Customs has a greater commitment at land ports. This information is shown in Table 6, appended to our statement.

What budgetary savings are claimed for these transfers? Customs would lose 638 positions and $24 million; however, these resources would be transferred to INS. By the same token, INS resources at air and sea ports would be transferred to Customs. The net effect: 0. The government claims not a dollar of savings for its proposal!

The reason is that the proposal before us is a compromise, and was deliberately labeled as such by OMB when Treasury and Justice could not agree. By contrast, the senior working group that developed options for the Cabinet Council's consideration produced five options, all but one of which entailed budgetary savings.

These options were: 1) consolidate primary inspections in Customs; 2) consolidate primary inspections in INS; 3) consolidate primary inspections at airports in Customs, status quo at all other ports; 4) consolidate primary inspections at land ports in INS, status quo at all other ports; and 5) consolidate full responsibility for passenger inspections in INS and retain responsibility for cargo inspection in Customs.

Of these options, it is significant that the one with the greatest savings, and therefore the most cost effective, was the first, consolidation of primary inspections in Customs. According to Customs, Option 1 would save 973 staff-years and $27 million. INS disputed these figures by maintaining that if Customs took over primary inspections, INS would require additional positions for secondary inspections. However, this view was contrary to the working group's assumption that, through proper training, no additional resources for secondary would be required.

Customs performed a detailed study of the additional resources required at each port of entry for full consolidation within Customs. It concluded that with 518 additional positions and no additional overhead it could assume primary inspection mission at all ports. These 518 positions are less than half the amount presently expended by INS on primary inspections, so there would be substantial savings from full consolidation within Customs. After subtracting $10 million required to fund these 518 positions, the Working Group estimated annual savings of $27 million from this option.

Later, Customs stated that it could assume the entire primary inspectional mission with no increase in resources. This would make the annual savings a minimum of $37 million, not counting future gains from streamlined procedures and consolidation of support systems and other overhead.

In its study, Customs found that with only 286 additional positions it could take over the entire inspectional mission at land ports. There would be no requirement for additional overhead or support systems, which were already in place. Customs would simply absorb immigration inspections at considerable productivity

savings, in the same manner that it has taken on responsibilities for 40 other agencies at the border.

By contrast, if the Administration's proposal is adopted, savings would be zero and the nation would end up with two border management agencies. As the draft Memorandum of Understanding between Customs and INS makes clear, INS would not only have responsibility for primary inspection of persons at land borders, but it would also have primary responsibility for all inspections, other than cargo inspections at the largest ports. At small ports, there will be no Customs presence and INS will inspect and process documentation for commercial merchandise. INS will perform both primary and secondary inspections to meet Customs' requirements with respect to commercial cargo.

At larger ports, there will be a Customs secondary to inspect and process cargo. But the INS port director will have sole responsibility for primary inspection of all traffic so Customs will lack on-the-spot authority to insure control over cargo so that its requirements and those of other agencies are met. This situation would be highly disruptive of narcotics, commercial fraud, Exodus and other programs Customs is charged with enforcing.

Only at the largest ports (Detroit, Port Huron, Buffalo, Lewiston, and Champlain) would Customs continue to inspect commercial trucks entering designated commercial vehicle primary lanes, and process all cargo.

The Memorandum of Understanding makes INS the exclusive authority in dealing with the independent governing bodies that control the flow of traffic across the U.S. border with respect to the primary processing of private passenger vehicles, taxis, buses, pedestrians and passenger trains. It makes Customs the exclusive authority in dealing with the independent bodies that control the flow of commercial trucks across the U.S. border into the primary or otherwise designated lanes. Without doubt, the Administration's proposal would continue to divide responsibility for enforcement at our land borders, and do so in a manner that is highly disruptive of existing Customs programs.

The Administration's proposal also perpetuates wasteful duplication between Customs and INS. Under the Memorandum of Understanding, each agency maintains responsibility for its existing enforcement support system (TECS for Customs and Service Lookout Book/Central Index for INS), and each agency is authorized to continue to develop systems that will enhance primary inspection. This duplication would be avoided if primary inspection at all ports were consolidated in a single agency. Moreover, INS presently lacks an automated system except at one airport, so making Treasury the single manager for enforcement support systems is an obvious solution.

Let me now recapitulate the arguments for consolidation of primary inspections entirely within Customs.

First, Customs is the nation's principal border management agency. It carries out responsibilites for 40 other agencies, and can do so for INS. There should be a single agency charged with border inspections.

Second, Customs is better prepared than INS to do the job. It has more Inspectors than INS at all ports of entry. It is now performing 60 percent of all immigration primary inspections.

Third, border management is Customs' sole business, whereas INS has other responsibilities. INS devotes minimal resources to border inspection because only .3 percent of those inspected are denied entry, and the principal threats it must counter are aliens crossing between ports of entry and overstaying their entry visas.

Fourth, consolidation within Customs is the most cost-effective of the options available, with minimum savings of $27-37 million annually, according to data developed by a senior working group chaired by CMB.

Fifth, there is a large potential for future savings through streamlining forms and procedures, new technology, and new enforcement and facilitation techniques. The potential saving is less if

consolidation extends to air and sea ports alone, which handle 12 percent of traffic, or if consolidation is divided between Customs and INS as in the Administration's proposal.

Sixth, consolidation within Customs will, during off-peak hours, provide additional staff for cargo inspection, thereby strengthening narcotics and commercial fraud enforcement programs. INS claims that this is off-set by its loss of capability to process aliens' claims and other adjudications which are processed by Inspectors during downtime, but its own studies have shown that distributing adjudication workload to ports to fully utilize Inspector downtime is an efficient means of processing such workload.

Seventh, Customs has automated enforcement support systems, including TECS and intelligence support, in place and a long track record of developing such systems, whereas INS has little or no such experience.

Eighth, consolidation within Customs is the least disruptive and easiest to implement because it maintains continuity with 40 other Federal agencies whose border interests Customs represents, and it does not require carriers, port operators, and the business community to deal with two agencies instead of one.

Ninth, overtime costs to the government would be reduced by an estimated $1.5 million per year through carrier reimbursement of inspectional overtime.

Tenth, immigration inspection is a straightforward process which Customs Inspectors are already performing; they can more readily take on immigration inspection than having INS become involved in merchandise inspection, narcotics enforcement, Exodus, and the requirements of 40 other agencies.

The obverse of these points is that consolidation in INS would be an unrealistic solution. It would fragment total border inspection responsibilities to an ever greater degree, double the need for coordination for the 40 agencies requiring border support, give INS extensive new

responsibilities which it is ill-prepared to absorb, and reduces narcotics enforcement at the worst possible time. It would reduce efficiency by maintaining redundant enforcement support systems, requiring the public to deal with two large border agencies whose interests may often conflict, and reducing the ability to shift resources between passenger and cargo inspection. When one considers the massive illegal immigration problem between ports of entry, and the major new tasks INS will confront if Simpson-Mazzoli is enacted, it becomes clear that consolidation in INS would be unwise. The nation needs a single border management agency, not two.

Nevertheless, INS has opposed consolidation within Customs. INS has argued that this option would: 1) fragment immigration procedures between two agencies and thus weaken immigration control at a time when document fraud is pervasive; 2) give Customs primary control of 61 percent of travelers who are aliens and should be under INS control; 3) require increased staff for INS secondary inspections resulting from more secondary referrals when Customs Inspectors perform primary inspections; and 4) require increased staff to process adjudications if primary inspectors cannot be utilized during downtime.

These arguments do not hold water. The major immigration threat is between, not at, ports of entry. While INS has an interest in 61 percent of the travelers who are aliens, Customs has an interest in 100 percent of them from the standpoint of narcotics, agriculture, public health and other enforcement requirements. Given that in excess of 500 experienced INS Inspectors would voluntarily transfer to Customs, and Customs Inspectors would receive additional immigration training, there is little basis for presuming a sharp increase in secondary referral. Finally, since consolidation could take place with little or no shift of funded positions from INS to Customs, INS would be left with sufficient positions to discharge its adjudications workload.

The times demand a single U.S. border inspection agency. This will permit INS to concentrate on the crux of the illegal immigration problem, border crossing between ports of entry. This Subcommittee can strike a blow for

both stronger enforcement of the narcotics and trade laws, and stronger immigration control, by adopting our proposal.

Adequacy of Inspectors at Ports of Entry

According to the U.S. Travel Data Center, visitors from abroad contribute more than $12 billion annually to the United States economy, generating over $1 billion in Federal, State, and local tax revenues and supporting 320,000 jobs. We have a national policy of encouraging foreign visitors to this country. Foreign visitors are now coming to the U.S. at the rate of 20 million a year, about 5 million from overseas and the remainder from Canada and Mexico.

This country has too much to lose by imposing roadblocks to the expansion of our tourism industry. Yet, as any visitor to our international air terminals and many other ports knows, even during peak hours many Customs processing lanes are closed for lack of staff.

The U.S. market share of international tourism has been falling in recent years. According to the Travel and Tourism Government Affairs Policy Council, the United States now gets only 8 percent of foreign tourists. A principal deterrent, according to the Congressional Tourism Caucus, is the long Customs lines that greet foreign visitors. The Air Transport Association, after a thorough survey, found that a minimum of 236 additional Inspectors was needed at airports alone.

In addition, many land border ports are still experiencing long lines during peak hours. Each year on the floor of the House, the Congressional delegation from Texas had demanded additional Inspectors for the ports of that State. Were it not for the economic crisis afflicting Mexico at the present time, and drying up much of the tourist traffic, the situation in the Southwest would be much worse than it is at present.

Red/Green Passenger Clearance System

At several international airports, Customs has introduced a new passenger clearance system, known as Red/Green. The theory behind this system, which Customs seems to be touting as the wave of the future, is that by giving passengers the opportunity to self-select either the green lane (no Customs items to declare) or the red lane, passenger facilitation is improved without reducing enforcement. The system is augmented by roving Inspectors who monitor passengers both in primary lanes and baggage areas, and who may designate individuals for immediate by-pass or for detailed secondary inspection.

This system, like many Customs has introduced in the past, might work if sufficient numbers of Inspectors were available. For any system to work, there must be adequately staffed primary lanes and an adequately staffed secondary. In the Red/Green system, there must be sufficient numbers of Inspectors to conduct primary inspection of passengers selecting green lanes as well as red lanes.

To start with an insufficient number of Inspectors, an inadequate secondary, a few rovers, and a handful of green lanes where passengers are whisked through with only cursory examination because to do otherwise would create a log-jam or a riot, is simply non-enforcement disguised as "selectivity". Customs management is insisting that putting passengers on the honor system, with inadequate primary and secondary inspection, and general supervision by a few roving Inspectors is the answer to clearing the terminal before the next wide-body jet comes in.

The gain in passenger facilitation is much approved by the airport operators and carriers. It is only our country that suffers from lack of an effective deterrent against drug smugglers, terrorists, and criminals of all types. The only answer to adequate facilitation and enforcement is to provide an adequate staff.

Our Inspectors are doing a splendid, courageous job. The trouble is there are not enough of them. Customs touts their seizures of narcotics and other contraband as proof that enforcement has not flagged. This praise is merited.

But Customs management should come clean and tell the full story, what is not being intercepted, what is getting through.

I'd like to read a brief passage from a letter our New York Chapter wrote to Customs managment officals:

> "On Tuesday, October 25, 1983, twelve Inspectors faced 1,447 passengers on one side of the Pan Am terminal. The passengers all arrived within 25 minutes. Once again, Inspectors refused to risk generating a riot and succeeded by ignoring their jobs."

Only adequate staff will allow a proper test of Red/Green. We trust the Subcommittee will approve our recommendations for additional Customs Inspector positions.

ACCEPT

The vast amount of commercial fraud designed to evade tariffs or quotas, to avoid anti-dumping or countervailing duty penalties, or to procure entry of counterfeit products has been amply documented by the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee. The loss to U.S. firms from counterfeit products alone has been estimated by the International Trade Commission as $6-8 billion annually. Much of this loss could be prevented if adequate numbers of Inspectors were available to inspect commercial cargo at our ports of entry.

One of the best indicators available of the adequacy of cargo inspection is the rate of inspection of containerized shipments. Large containers now account for more than 70 percent of U.S. seaborne commerce, and are a growing proportion of air and surface shipments. In FY 1980 Customs performed a total of 81,234 inspections on a total of 2,800,000 arriving containers, for an inspection rate of 2.9 percent.

Since that time, the inspection rate has fallen as Customs introduced "selectivity" in cargo inspection through the ACCEPT program. ACCEPT, which stands for Automated Cargo Clearance and Enforcement Processing Test, is an area

where Customs is moving headlong toward adoption of a new inspection system without proper evaluation of the impact on enforcement. The idea behind ACCEPT is that since Customs can make only a limited number of inspections, these should be concentrated on "high risk" shipments where the pay-off is potentially greater for the resources expended.

The problem is how to determine which are the "high risk" shipments. It is not possible to set up a computerized system for fingering the shipments to be checked, as ACCEPT attempts to do, without a great deal of data collection and construction of profiles of the characteristics of "high risk" shipments and "high risk" importers. There is no evidence that Customs has collected this data and constructed the profiles, let alone tested them. What we can expect from this system is "garbage out". The system will do a less than adequate job in guiding Inspectors to the shipments that need checking.

Since there are too few Inspectors, ACCEPT is a rationalization for performing fewer and fewer inspections while commercial fraud mounts. Customs contends that enforcement has not suffered, pointing to the results obtained from the efforts of Inspectors and Contraband Enforcement Teams. But the House Commerce Committee's hearings on the volume of commercial fraud have reduced this claim to tatters.

The fact is that a certain minimum level of inspections are required to provide a sufficiently high probability of interception of illegal shipments. When staff is insufficient the limited number of inspections may indeed produce results, but when those results are extended over the entire population of shipments, they demonstrate that a massive amount of illegality is not being caught. Customs' use of "selectivity" is simply a rationalization of the circumstances in which it finds itself lacking an adequate staff to do an effective job.

ACCEPT is supposed to be a computerized system, with a central computer designating to the Inspector which shipments are to be inspected. In many ports, however, a computer hook-up is not available, or may not be functioning, so a "manual" ACCEPT has been instituted. This means a headquarters supervisor designates the inspections to be made. From the standpoint of enforcement, both

computerized and manual ACCEPT are utterly untested systems. Their principle effect is to limit the number of inspections, thereby speeding the flow of merchandise from docks to warehouses without inspection, greatly multiplying the opportunity for commercial fraud.

In order to implement ACCEPT, Customs has had to rewrite the Tariff Act of 1930. Section 499 of the Act requires inspection of not less than one package of every invoice and not less than one of every ten packages of imported merchandise. The law authorizes the Secretary of the Treasury to provide, by regulation, that a lesser number of packages may be examined when, in his opinion, the examination of a lesser proportion will amply protect the revenue. This provision allows the Treasury Secretary to reduce the number of inspections required, but not to totally abrogate the requirement for minimum inspection contained in the law. However, on September 10, 1981, Customs issued a regulation which allows the release of merchandise with no inspection at all.

Last year, we called for public hearings on ACCEPT and the related Customs regulation of September 10, 1981. We also urged this Subcommittee to bar any funds for implementation of ACCEPT until this panel is satisfied that the public interest is protected by adequate physical inspection of incoming cargo.

We again strongly urge the Subcommittee to act on this important matter. We also urge approval of additional Inspectors for cargo inspection and commercial fraud enforcement, as contained in NTEU's alternative budget (Table 3). We wish to note that the House Energy and Commerce Committee likewise recommends additional Inspectors for this task.

Operation Exodus

Operation Exodus was initiated by Customs in late 1981 to step-up enforcement of the export control laws. The FBI had discovered a pervasive pattern of activity by Soviet agents to obtain American technological secrets by means of bribes and other inducements. Their targets were lasers, fiber optics, computers, and telecommunications equipment.

The Senate Permanent Investigations Subcommittee after a two-year inquiry has confirmed that the Soviets are engaged in a massive effort to acquire Western technology by any means, and have been able to use such technology to modernize and speed the development of their weapons systems. Such advances require responses by our own military establishment, and this increases the size of our defense budget.

As a CIA report on this subject explains:

> "It is clear that the Western military expenditures needed to overcome or defend against the military capabilities derived by the acquisition of Western technology far outweigh the West's earnings from the legal sale to the Soviets of its equipment and technology."

Examples continue to appear which demonstrate the need for this program. On February 4th 1985 it was reported that 17 Hughes helicopters, which can readily be converted to military use, were illegally diverted to North Korea by the West German distributor for Hughes. In addition, another 70 helicopters the same distributor purchased from Hughes are not accounted for and may also have been sold to North Korea.

Operation Exodus has scored some notable successes, but is handicapped by understaffing and lack of cooperation between Customs and Commerce. Only 292 staff-years are allocated to the program, and Commerce refuses to allow Customs access to its files on licensors. At the same time, Commerce has stepped up its enforcement efforts in the hope of becoming the border enforcement agency for exports. The export enforcement mission is further complicated by Customs' enforcement of the Munitions Control Act for the State Department. We urge this Subcommittee to take a strong stance in favor of a single agency - Customs - being in charge at our borders, and to communicate this position to the committees responsible for re-authorization of the Export Administration Bill.

Inspectional Overtime

Inspectional overtime has become a critical resource for meeting Custom's growing demands for clearance of passengers and cargo. For nearly a decade, a virtually static inspectional force has had to process a growing number of air travelers and cargo shipments. With its workforce limited by OMB personnel ceilings, Customs inspectional overtime expanded to fill the gap between workload and resources.

An Inspector with overtime earnings of $15,000-$20,000 a year works an average of 62 hours a week, 52 weeks a year. A 1981 Customs study of overtime showed that, in addition to a normal 40-hour week, the average Inspector is required to work three of every four Sundays, one Saturday per month, and seven week-day overtime assignments per month. The requirement for this overtime is driven by the demand of carriers for Customs inspectional services during other than normal duty hours of the port. Because of the growing workload and limited staff, it is evident that an extensive commitment to inspectional overtime is essential if Customs is to accomplish its mission.

For Inspectors to make themselves available such long hours, particularly on Sundays and holidays when other citizens are vacationing, adequate monetary incentive must be provided. The most recent data collected by Customs shows that Inspectors are earning, on the average, 2.1 times the regular rate of pay on Sundays and 2.4 times the regular rate on the other days of the week. The Customs' study attributes the 2.4 rate of pay to the call-back of Inspectors who have left the worksite. Such call-backs frequently occur at night and at irregular hours, taking a physical toll on the Inspector. The study also confirms that the average Inspector works 7 hours on each Sunday assignment, and an average of 8 hours if holidays are included in this figure.

We are convinced that the frequent call-backs, the late-night hours spent away from home, and the physically demanding nature of inspectional duties justifies the present rate of overtime pay. Moreover, these rates of pay conform with the prevailing overtime rates in the private

sector which normally establishes double time premiums for call-back and night work, and where the typical practice is triple time for Sunday overtime and double time and one-half for holiday work.

Nevertheless, the Administration has recommended a joint Customs/INS inspectional overtime bill which would establish the rate of pay for inspectional overtime essentially at time and one-half. We believe such provision would not only be unfair to Inspectors, but would reduce the incentive to continue to work long hours at a time when the Service is stretched thin and already lacks adequate staff. Such proposals only go to show how insensitive and callous this Administration can be. We would like to offer those who helped prepare this proposal the opportunity to work with a Customs Inspector for just one day at one of our airports. We believe they would begin to question the desirability of perpetuating this outrage. We urge the Subcommittee not to be deceived by their specious claims, and to firmly reject any attempt to modify the rates of pay specified in the Act of 1911.

We also urge the Subcommittee to remove the $25,000 cap on Customs Inspector overtime earnings. The overtime cap has long outlived its usefulness.

Proponents of the cap claim to be acting in the employee's interest by limiting the amount of overtime Inspectors could be compelled to work. However, the overtime cap had exactly the opposite effect and completely eliminated the voluntary aspect of overtime. This is because Inspectors are required to rotate overtime assignments so that the earnings of all can be equalized.

Prior to imposition of the cap, Inspectors were able to work out an allocation of overtime duty which took into account their personal needs. Inspectors who wanted to earn more money and were willing to sacrifice their free time or work late at night volunteered for overtime, while Inspectors who had family obligations or other commitments did not. And although this system lead to an imbalance in earnings, morale, efficiency, and productivity were greatly enhanced.

We strongly believe that employees willing and able to work overtime without foregoing family obligations should be permitted to do so, and that the burden of forced overtime should be minimized. Morale at the workplace is fostered by allowing individual preferences to play a greater role in the assignment of overtime, not by a rigid policy of equalization of earnings.

Customs itself has urged Congress to remove the overtime cap. Treasury Department officials have testified that, in addition to costing $1 million a year to administer, the cap is preventing Customs from properly allocating its limited resources among ports experiencing different rates of growth. It should also be noted that about 60 percent of all overtime is reimbursed to the government by the carrier which requests clearance after normal port hours.

Delegation of authority to waive the cap has been granted to Customs by Congress. We submit that the time has come to remove the cap completely, in favor of Customs internal controls. We strongly urge the Subcommittee to adopt this course of action.

Adequacy of Inspectors for Commercial Fraud Enforcement

Last year, NTEU conducted an analysis to determine the number of Inspectors required in containerized cargo processing essential to commercial fraud enforcement. Our analysis showed that in order to raise the number of inspections to 105,000 per year, 483 additional Inspectors would be required.

This year, NTEU performed a further analysis of Inspector requirements for cargo processing based on historic data showing a fairly constant ratio of entries to cargo processing based positions. This analysis is presented in Tables 7-12 appended to our testimony. It shows that an additional 900 Inspectors would be required to process about a million additional entries now being by-passed, with a net revenue gain of $1 billion.

Many containers proceed in-bond to Customs bonded warehouses. Customs has removed its physical presence from

bonded warehouses, in effect placing the warehouse proprieters on the honor system. We have urged the Subcommittee to halt this program, arguing that the potential for fraud, abuse, and scandal is huge. Our fears have now been amply borne out by the findings of the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee. That Subcommittee has urged re-establishment of the Customs warehouse program, with a permanent Customs presence at the warehouses. We fully support this move, and urge you to authorize the required resources, estimated to be 300 average positions.

Radio Preliminary Entry

We would like to bring to this Subcommittee's attention a new wrinkle in Customs management's attempt to obfuscate the woefully inadequate enforcement resources by instituting a new entry procedure touted as a "modernistic approach to an antiquated system". Called the "Radio Preliminary Entry" (RPE) it would allow masters of vessels to receive preliminary entry by radio-telecommunications or other electronic transmissions of manifest data obviating the physical boarding of the vessel by Customs officers. The procedure allows vessels to enter a port without the mandatory physical boarding in order to grant preliminary entry. Formal entry of the vessel must be made within 48 hours of arrival. It's but another example of opening our borders without physical inspection and is fraught with the potential of increasing the flood of narcotics and conterfeit goods into this country.

TARIFF AND TRADE

By-Pass

NTEU has brought the growing shortage of Import Specialists relative to rising entry workload, and the disasterous policy of "by-pass" by which Import Specialists do not review 60 percent of entries, to the attention of this Subcommittee for the past four years. The dimensions of the problem have now become painfully obvious. Relative to Hitachi's attempt to acquire design information and

component parts of IBM's latest generation of business computers, Chairman Dingell wrote Chairman Royal last week:

> "As recorded on tape, the FBI undercover agent asked senior Hitachi engineers how they planned to get past Customs, what they believed to be stolen IBM component parts, which were the size of a pool table. Amidst laughter, the Hitachi officials stated that U.S. Customs is no problem."

Just recently, the U.S. International Trade Commission and the House Oversight and Investigations Subcommittee both released reports on the flood of counterfeit products entering the U.S. market. The ITC said that counterfeit goods cost U.S. companies $6-8 billion a year and the loss of 131,000 American jobs. The House Subcommittee said that the U.S. auto parts industry estimates that it loses $3 billion in sales each year because of counterfeit products and that "dangerously substandard parts" for helicopters have been faked. Said Chairman Dingell:

> "Any American who drives a car, flies in an aircraft or depends upon a wide range of medical devices, pharmaceuticals, or personal care products is placed in jeopardy because of substandard and dangerous foreign counterfeit products."

Calling funding for the Customs Service "woefully inadequate", Mr. Dingell said that "the decline in this country's international competitiveness is due, at least in part, to inadequate policing of our laws against illegal and unfair trade practices." The Reagan Administration's budget plan to cut the number of Customs employees is "a form of fraud against the American worker and consumer." Last year, the Chairman recommended a $29 million increase above full restoration of the cuts.

Shocked into action by Customs' inability to deal with a torrent of fraudulent imitations, many companies have hired their own investigators. Undercover witnesses at the Dingell hearings told how U.S. electronics technology is stolen, copied and exported back to this country. Apple Computer investigators indentified one plant in Taiwan capable of producing 3,000 fake Apple computers each month. When fake Apple computers appeared recently in

Philadelphia, the company's agents tipped off Customs and a large quantity which had been shipped concealed as machinery was seized. The U.S. manufacturer of "Cabbage Patch dolls" led Customs to the importer of counterfeits which were unsafe by U.S. standards for flammability. Such efforts are a measure of the cost to U.S. industry of dealing with a problem that Customs lacks the resources to cope with.

Steel fraud is pervasive. The Chairman of the Steel Caucus, Senator John Heinz, told the Dingell committee that there are currently 40 active cases of steel import fraud under investigations. Describing the lack of physical facilities at U.S. ports for detecting fraud, and lax enforcement resulting in only minor slaps on the wrist, Senator Heinz concluded that:

> "Investigations proceed at a snail pace, fines are inconsequential, convictions rare, resources shrinking and the deterrent nill. Our government has unwittingly issued an invitation to 'fraud without fear'".

Senator Heinz pointed out that Commerce Secretary Baldridge had stated that aggressive enforcement of our trade laws could limit steel imports to 15 percent of the U.S. market. Customs' resources are inadequate to the task, and:

> "Customs has compounded the problem by proposing a program to drastically reduce the manpower levels of Import Specialists at the same time it has proclaimed import fraud as an area of renewed emphasis. Import Specialists are essential to fraud detection and they need additional support, not lip service. And they certainly do not need cutbacks."

This view was echoed by the Dingell committee which said:

> "When faced with the problem of unfair trade practices which result in a substantial loss of revenue to the government, the agency has apparently chosen to reduce entry document scrutiny rather than increase personnel."

The Dingell committee also faulted mis-utilization of Import Specialists which led to loss of expertise.

> "Certain ports, notably Chicago, have adopted a system of rotating the Import Specialists' commodity assignments, thus reducing whatever expertise may remain.....In one port with a very large textile and apparel fraud problem, the number of Import Specialists has been reduced to three. In addition, one was given the assignment of monitoring apparel imports for most of the world after only one week's training. In another port which handles a large volume of steel, an Import Specialist with only a few months of experience and virtually no expertise in steel was given that commodity line.....Part of this system is the 'by-pass' program, under which the entry documents are not reviewed at all. There is great pressure on district directors to increase the number of entries on 'by-pass'. 'By-pass' guidelines are built into the performance evaluation requirements for Import Specialists in some ports. Even where they are not, the 'by-pass' goals often exceed 70 percent of all entries of non-restricted merchandise. To me, this would appear to be a license to steal."

We believe that Mr. Dingell is dead right. Customs management seems determined to destroy the priceless expertise of the small corps of Import Specialists who are the nation's principal defence in these difficult times. By failing to fill Import Specialist vacancies, cutting off Import Specialists from the trade community by centralizing them at only a few ports, downgrading their role through by-pass systems, and introducing "import generalists" and "industry import specialists", Customs is gradually destroying the talent and expertise upon which the nation must depend to deter and prevent commercial fraud.

Centralization of Entry Processing

Import Specialists are the technical and commodity experts who are the backbone of the Customs' trade operations. Import Specialists review entry summaries, ensure proper classification of merchandise in accordance

with the Tariff Schedules, ensure that shipments are valued properly, scrutinize importations of sensitive commodities to enforce applicable quota or anti-dumping and countervailing duty requirements, make determinations that products are admissable under U.S. law, and enforce the requirements of many other agencies, such as the Agriculture Department and Food and Drug Administration, to ensure that imports are safe for consumption.

Import Specialists ensure that duties are correctly calculated and timely deposited with the Treasury. They are responsible for collecting over $10 billion in annual revenue. It is well recognized by Customs that the more Import Specialists there are assigned, the greater the revenue collection will be.

Import Specialists are in daily contact with the business communities they serve. They hold office conferences with manufacturers and importers to explain U.S. trade laws and apply thier intimate knowledge of legal precedents and rulings to complicated questions relating to proposed importations. They make over 8,000 visits a year to the premises of importers to view product samples, verify invoices, inspect product markings, and explain Customs requirements. These contacts with the business community are an invaluable contribution to the economic health of the region they serve. Moreover, they benefit Customs by assuring fewer errors in entry documents and fewer change liquidations (a "change liquidation" of an entry requires an upward or downward adjustment of the duty deposited when the entry documents were presented).

It goes without saying that the presence of one or more Import Specialists at a port of entry is of inestimable value to the business community, serves as a stimulus to foreign trade, and may even cause importers, brokers, distributors and warehouses to locate in the vicinity. The closure of Import Specialist offices would constitute a visible downgrading of the stature of the community as a port of entry, and raise justifiable fear of the loss of business to other regions. For example, in arguing against the transfer of two Import Specialists from Milwaukee, the port director told Customs:

> "If we don't have a full customs service here we are deeply concerned that they (importers) might go to Chicago."

A city official stated that many industries located in Milwaukee because of the port, and:

> "If you're saving peanuts by moving these people down there (Chicago) I can't see the reason for it. This could be very, very devastating to us."

An official of General Electric Company added that GE needed Import Specialists in Milwaukee because of the complex nature of the product line imported by the company.

> "Face-to-face contact, understanding and education is critical to our business,"

he told Customs. GE estimated that elimination of the Import Specialists would cost the company $200,000 a year in additional broker fees, duties, communications, personnel and training.

We believe that loss of service to the business community is the paramount reason why the Subcommittee should reject Customs' plan to close down full-service entry processing offices at many locations. Customs has not taken adequately into consideration the effect upon the economic health of these communities, nor has it provided the economic impact statement required by executive order.

There are several other cogent reasons why centralization of entry processing is a bad idea. We would like to briefly touch on the most important of these.

First, Import Specialists' physical presence at ports is essential to ensuring that correct data is submitted on entries. One of the most important services of the Import Specialist is pre-acceptance review of entry documents. During these reviews, numerous errors are corrected that increase the number of "no change" liquidations and result in the collection of $53 million a year in added revenue -- more than the cost of the entire Import Specialist work force.

A Customs survey of rejected entries conducted in May 1980 found that 16 percent of all entries reviewed by Import Specialists were rejected due to errors. Classification and valuation errors are the most numerous, and 549 entries of quota merchandise were erroneously presented as not subject to quota. In commenting on this last finding, the director of Customs' Office of Trade Operations stated:

> "The unlawful entry of 549 shipments of quota merchandise would have had catastrophic repercussions."

As a result of pre-entry review of documents by Import Specialists, Customs saves large sums of money by not having to process change liquidation. Each change liquidation costs Customs approximately $20 to make. At present, about 70 percent of total entries are liquidated with no change. If pre-entry review is no longer performed for many importers and brokers because of the relocation of Import Specialists, the number of change entries is bound to rise significantly. A total of 7 million formal entries are anticipated by Customs in FY 1986. If just 10 percent fewer entries were liquidated with no change, the additional change liquidations would cost Customs $14 million to process. This is equal to the entire amount of the budgetary savings claimed for the centralization plan.

Second, one of the most important functions of Import Specialists is to make on-the-spot determinations of admissability. Under normal procedures, most imported goods can be released upon inspection by a Customs Inspector. However, there is a wide range of products for which immediate delivery cannot be allowed because of possible danger to the public health and safety, or economic loss, if the goods enter the stream of commerce. Such goods are quota-class merchandise, manufactures tht might infringe upon U.S. patents or copyrights, medicines and chemicals that require proper marking, foodstuffs that require Agriculture or FDA certifications to protect consumers, importations that might be in violation of endangered species laws, and shipments that require a country-of-origin determination before entry can be permitted. The presence of Import Specialists at the port, where they can physically inspect shipments and take samples for laboratory testing if required, is essential for proper admissability determinations. This function cannot be delegated to Inspectors

because technical knowledge of commodities, and of applicable Customs rulings and legal precedents, is required.

Third, Import Specialists' personal knowledge of the importer and broker community, together with their ability to verify invoices by visiting premises to inspect purchase orders, vouchers, and records of payment, are important for the detection of commercial fraud and effective enforcement of our trade laws. Most commercial fraud cases start with a referral from an Import Specialist. This may trigger a follow-up regulatory audit or investigation by other components of Customs. These activities are uniquely dependent on the crucial role the Import Specialist plays in fraud detection through document verification and ability to note when something "isn't right" about an importation. If Import Specialists are moved hundreds of miles away from the importing community at a port, trade law enforcement is bound to suffer and instances of undetected commercial fraud will multiply to the detriment of American workers and American industry.

Fourth, relocation of Import Specialists would break up the Import Specialist-Inspector team that is vital to the smooth operation of our ports of entry. The range of commodities that an Inspector must examine is too great to permit him the expertise needed for a proper inspection and determination of admissability. Consequently, the Inspector depends upon the Import Specialist to provide him with expert information, and the Import Specialist may often join in the inspection. Such teamwork is the bedrock of the entire system. It has, for example, prevented botulism-contaminated foodstuffs from entering the stream of commerce. By removing the Import Specialist from close contact with Inspectors, there is a greater likelihood of a shipment being released before its admissability is discovered. Import Specialists can best perform their duties on the line -- close to the trade community and the Inspectors -- and not at some location far removed from the ports of entry.

Fifth, Customs experimented with a similar system of centralized entry processing several years ago. Under this system, Import Specialists at different ports were assigned

commodities for which they would have responsibility for classification and appraisement. Merchandise imported at one port might have its entry processed at another port. This experiment proved a complete failure. Not only did it take longer to process the entry, but it became virtually impossible to contact the Import Specialist who was actually responsible for reviewing it. As one Customs Broker recalled the experience:

> "This method proved to be very costly and cumbersome to the U.S. Customs Service; therefore, this plan or program was discontinued. Almost immediately, there was a remarkable improvement in the appraisement of merchandise.."

We believe Customs is now heading in the direction of repeating this unfortuante failure.

Customs asserts that its plan will achieve budgetary savings through reduced overhead, and facilitate automation by permitting larger numbers of entries to be processed at one central location. But automation will be of little benefit to Customs if much of the broker data submitted is incorrect. It is the presence of the Import Specialist in the trade community that permits a relatively high percentage of correct entries. The increase in the number of change liquidations resulting from centralization would alone wipe out the purported budgetary savings of $10 million. Moreover, Customs has failed to adequately consider the substantial economic impact on the communities that would lose Import Specialists, and the impact on industry of a reduced capability to detect commercial fraud.

We therefore call upon the Subcommittee to insist that Customs cease at once all current and planned relocations of Import Specialists, to lift the hiring freeze on Import Specialists in districts where such a freeze exists, and to promptly fill vacant Import Specialist positions at ports where such positons are authorized. In its authorization bill, the Subcommittee should require Customs not to implement any plan for the centralization of entry processing locations.

Automated Broker Interface

The automated broker interface (ABI) allows Customs house brokers, representing importers, to electronically transmit data to Customs. The system is in use, or planned for use, at New Orleans, Buffalo, Houston, Philadelphia, and Baltimore, with plans for expansion nationwide. Import Specialists have always strongly supported sensible automation efforts in the past, but in view of Servicewide by-pass requirements and continued high rates of broker errors on entry documents, most of which favor the importer, they fear that this new system will not provide adequate scope or judgement in processing entry documents. The result would be inadequate control over quota and restricted merchandise, loss of revenue, and reduced accuracy of trade statistics.

To illustrate, if a broker doesn't enter the right tariff classification, and the merchandise is of a type that requires sampling to determine admissability, samples won't be taken and the product will enter. On by-pass, the Import Specialist might not even see the entry. In this way, the system loses control.

Candy can be classified into 20 different categories under the tariff schedules, ranging from 0-17.5 percent duty. If the broker's clerk makes an error, and a Customs aide reviews the entry under by-pass, the scope for error is obvious. In the past, scissors have been invoiced as hand tools. Sugar has been invoiced as cookies; the entry for cookies is by-passed, but sugar is under quota.

Customs management objects to pre-entry review by Import Specialists of brokers' documentation. But this practice gives the Import Specialist the ability to correct errors in classification and value, and ensure accurate trade statistics are reported to the Census Bureau.

There have been many studies and tests by Customs which have documented various broker error rates, normally averaging about 30 percent. Nevertheless, Customs does not seem to have developed ABI with quality control in mind. The problem is compounded by the by-pass system. The

Dingell committee drew attention to this problem by recounting a test made by Customs last year.

> "Last spring, an experiment with 100 percent by-pass was carried out in the Chicago district. For 30 days, all entries of non-restricted merchandise were accepted as submitted. The Import Specialists then had 30 days to review these entries. Under the pressure of a doubled workload, the error rate uncovered was 21 percent. Even more important, Customs brokers and large importers had been officially notified of the test, thus skewing the results toward fewer errors. Moreover, 35 percent of all entries were on by-pass, and these were excluded from the test. The government collected $1,500,000 in duties that would have been lost under 100 percent by-pass."

The solution to these difficulties lies in 1) ensuring an adequate number of Import Specialists, 2) upgrading their role and maintaining their expertise, 3) distributing them more widely among the business community rather than centralizing them in fewer locations, 4) reducing the by-pass rate to an acceptable level, 5) ensuring that Import Specialists review all entries to determine whether by-pass should be made, 6) allocation of sufficient Import Specialist staff-years for pre-entry review and adequate quality assurance, and 7) consulting with Import Specialists before planning further development of the Automated Commercial System (which includes ABI) so their collective expertise can be brought to bear in shaping this new system.

Adequacy of Number of Import Specialists .

NTEU has completed three studies of the adequacy of the number of Import Specialists to process the growing entry workload and to deter commercial fraud. The first analysis is presented in Table 5. It shows that while the number of merchandise entries will more than double from three million to seven million between 1975 and 1986, the number of Import Specialists will decrease from 1,262 to 1,023 at present funding levels. Assuming an average annual rate of productivity growth of 4.3 percent per year, the number of entries each Import Specialist would be capable of processing in 1986 would be 4,000 entries. Dividing this into the entry workload yields 1,762 Import Specialists required as a

minimum adequate staff, which is 740 positions above the present level.

At the request of the House Energy and Commerce Committee, NTEU last year developed estimates of the number of Import Specialists, Customs Inspectors, and Special Agents required for adequate enforcement and deterrence of commercial fraud at three different enforcement levels. For 20 percent by-pass, 1,400 Import Specialists would be required, or 358 above the current level. For details see our FY 1985 testimony.

A further study presented in Tables 7-12 appended to our testimony shows that 260 additional Import Specialists would permit processing of 975,000 additional entries, reducing the by-pass rate from 60 to 45 percent and yielding $1 billion in additional revenue. This assumes that marginal revenue is $1,200 per entry compared to an historic average of $2,000 per entry, and that the Import Specialists are part of a total package of 1,200 additional cargo processing personnel.

NTEU believes that Congress should establish as a goal an additional 500 Import Specialists, to be attained over a three-year period. Last year, 150 additional Import Specialist were authorized, but funds were not appropriated. We again strongly urge the Subcommittee, in the face of the massive trade law enforcement problems facing the nation, to allow an additional 150 Import Specialists above the current level for Fiscal Year 1986.

TACTICAL INTERDICTION

The dedicated men and women of the Customs Patrol are responsible for the interdiction of narcotics and contraband entering the United States by air and sea or across our land borders. Patrol functions include air and marine interceptions, covert operations, participation with contraband enforcement teams in cargo enforcement operations, participation in Exodus and commercial fraud

task forces, and use of mobile strike teams to respond to smuggling activities.

Special action units of the Customs Patrol are designed to ferret out activities which evade normal Customs processing. These special action units possess unique knowledge of cargo movement and documentation, vessel search and surveillance procedures, smuggling and other criminal techniques, and ability to operate from aircraft, ship, and surface vehicles. They work hand in glove with other elements of Customs, spanning the gap between inspections and investigations.

As we have previously stressed, Customs Patrol Officers at land ports of entry are specially trained to support the Customs mission. The Administration's proposal to transfer 165 of these positions to INS would gravely weaken narcotics, Exodus, and commercial fraud enforcement efforts. These specialized resources should be left within Customs, and we strongly urge the Subcommittee to bar their transfer.

In testifying before the Select Committee on Narcotics Abuse and Control on the serious threat of narcotics smuggling by ship, the Commissioner of Customs stated, "The threat we face in the marine area is again tremendous, it's one particular area where we are going to try and beef-up our resources."

This year's budget provides some modest resources for the Marine Patrol, to include an experimental sea module. The task is huge and Customs' present fleet is antiquated, but the start is welcome.

This Customs Air Patrol must continue to be strongly supported, and we commend the Subcommittee for its efforts in developing a second Customs air module as well as procurement of aircraft, radar, and other assets from the Department of Defense.

We have earlier described the vast dimensions of the commercial fraud threat to this country. Countering this threat will require strengthened enforcement of Customs patrol at air, land, and sea ports of entry. We need stronger patrol of our docks and harbors, and better surveil-

lance of bonded warehouses and foreign trade zones. The Dingell Subcommittee has stated:

> "That serious problems existed with bonded warehouses should be no surprise. Lax enforcement in previous years had led to several scandals involving goods disappearing from bonded warehouses."
>
> "Customs officials experience even more problems with foreign trade zone warehouses.' These are intended to house merchandise for re-export. It is Customs' policy not to inspect the goods as they enter or leave the zones. In one part of the country, counterfeit jeans were being sold in foreign trade zones. Shirts reportedly scheduled for trans-shipment to South America were on their way to New Jersey when discovered. Perfume was magically transformed into baby shampoo and sand in another warehouse. Stories abound of containers full of goods entering foreign trade zones and exiting empty or filled with other goods. Falsification of paperwork appears to be a simple matter."

Customs will not get a handle on this problem without more special enforcement operations, strengthened contraband enforcement teams, and investigations in which Customs Patrol Officers participate. We believe there should be a long-range plan for strengthening this arm of the Service, and we ask the Subcommittee to approve 50 additional positions in Fiscal Year 1986. The funds for these positions are contained in the alternative budget we have presented.

SUMMARY OF NTEU'S RECOMMENDATIONS

NTEU recommends:

Approval of $716,192,000 and 14,068 average positions for Customs for FY 1986. This is an increase of $77 million and 1,527 average positions above the Administration's budget request. The increase includes

$46.6 million and 877 average positions to restore cuts made by the Administration and maintain current operating levels. It also includes an additional $30.4 million and 650 average positions for 400 Inspectors, 150 Import Specialists, 50 Customs Patrol Officers, and 50 Special Agents to strengthen Customs enforcement.

Congress should set as a goal achievement of the following increases in Customs over the next three years:

a. 1,500 Inspectors as follows:

(1) 350 positions for airports (based on the Air Transport Association's recommendation of 236, plus 114 additional positions for passenger and cargo growth, staffing of new gateways, and assumption of INS primary inspections);

(2) 300 positions for land border ports (based upon Customs' study that 286 positions are required for assumption of INS primary inspections);

(3) 450 positions for commercial fraud enforcement based upon NTEU's study of the number required to raise the inspection rate for containerized shipments to 3.5 percent);

(4) 100 positions for export control (based upon the minimum required number of Inspectors for the Exodus program);

(5) 300 positions for inspection of warehouses and foreign trade zones (based upon number of positions in former Customs warehouse program).

b. 500 Import Specialists (based upon NTEU's studies).

c. 200 Customs Patrol Officers (for narcotics and commercial fraud enforcement).

d. 100 Special Agents (primarily for commercial fraud enforcement).

As the nation's principal border management agency, Customs should be assigned primary inspection responsibility at all ports of entry. The plan to consolidate primary inspections within Customs at air and sea ports should be approved and implemented, but the plan to transfer primary inspection responsibility and Customs Patrol positions at land ports to INS should be rejected. Customs should be assigned responsibility for primary inspection at land ports of entry, thereby freeing resources for the Border Patrol, which could concentrate on its mission of apprehending illegal aliens between ports of entry.

The Subcommittee should initiate a full inquiry into the ACCEPT program, and not authorize Customs to proceed with this program except in accordance with an approved plan, including phasing in of additional inspectional resources, to deter and minimize narcotics smuggling and commercial fraud.

The Customs warehouse program should be re-instituted, and there should be a greater Customs presence in foreign trade zones, as a deterrent to commercial fraud.

The Subcommittee should direct that Customs immediately establish criteria, and allocate sufficient Import Specialists, to ensure no more than 45 percent by-pass of merchandise entries in FY 1986. Import Specialists

should review most entries to determine whether by-pass is appropriate. If the number of Import Specialists is insufficient to achieve this goal, Customs should so notify the Subcommittee so that it may make an appropriate recommendation in Congressional consideration of Treasury's supplemental appropriation request for FY 1986. Customs should be required to evaluate the results of 45 percent by-pass, including impact on revenue and commercial fraud prevention, in order to permit Congress to determine whether this rate should be adjusted.

The Subcommittee should direct Customs to upgrade and strengthen the Import Specialist's role as the backbone of commercial operations, including measures to enhance professinal development and improve expertise in the various commodity lines.

The Subcommittee should permanently bar the centralization of Customs' appraisement locations, and require Customs to give six-months notice of any planned port or office closures.

The Subcommittee should mandate allocation of a sufficient number of Import Specialists for pre-entry review of brokers' documentation, in order to minimize broker errors; provide for review and correction of data entered under the automated broker interface program; and consult with Import Specialists to design a quality assurance program for the Automated Commercial System (which includes ABI) to maintain the integrity of classification and valuation requirements, tariff and quota controls, data required for anti-dumping and countervailing duty determinations, and accuracy of foreign trade statistics.

Customs Patrol should be strengthened by a minimum of 50 positions at all ports of entry, proposed augmentation for the air support program should be provided, and the amount requested in the budget for integrated data telecommunications network and upgrading of TECS should be approved.

In view of the grave drug threat of the past decade, and the rise of international terrorism as well as greater law enforcement cooperation in the apprehension of criminals, the Subcommittee should recommend to the Congress and to the Committee on Post Office and Civil Service that Customs Inspectors be eligible for special early retirement as law enforcement officers.

The Subcommittee should recommend to the Congress that the uniform allowance of uniformed employees of the Customs Service be established at any amount up to $425 annually.

The Subcommittee should bar the expenditure of funds for implementation by Customs of radio preliminary entry of vessels, in view of the drug and commercial fraud threats and potential for abuse.

Mr. Chairman, this concludes our testimony. My staff and I will be happy to answer any questions.

TABLE I

COMMERCIAL FRAUD THREAT TO THE UNITED STATES, FY 1986

	ESTIMATED ANNUAL VALUE	ESTIMATED REVENUE LOSS
Goods Imported but Unreported	$25 Billion	
Counterfeit Goods	$12 Billion	
Goods Imported in Violation of Tariff and Trade Agreements		
1. Steel	$600 Million	
2. Textiles	$500 Million	
3. Other	$500 Million	
Grand Total	$38.6 Billion	$3.0 Billion[1]

1. The average rate of duty on dutiable imports is 8%. Applying this rate to $38.6 billion yields a conservative estimate of the revenue loss, as fines, penalties and forfeitures, in addition to duties, would be involved in actual cases.

TABLE 2

ILLICIT DRUG THREAT TO THE UNITED STATES

SUPPLY (Metric Tons)

	1978	1979	1980	1981	1982	1983	1984	%Change 1978-1982
HEROIN	3.7-4.5	3.4-4.0	3.6-4.3	3.89	4.08			0
COCAINE	19-25	25-31	40-48	34-45	45-54			+125%
MARIJUANA	8,800-11,900	10,000-13,600	10,200-15,000	9,600-13,900	12,000-15,000			+30%

TOTAL RETAIL VALUE (Billions of 1980 Dollars)

		56-74	70-90	75	85

REMOVAL (Quantity seized in metric tons)

HEROIN	.35	.19	.23	.15	.27 (7% of supply)
COCAINE	1.4	3.4	3.5	2.0	5.64 (11% of supply)
MARIJUANA	1191	671	731	937	1336 (10% of supply)

Source: Narcotics Intelligence Estimates

TABLE 1

U.S. CUSTOMS SERVICE FY 86 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 86 BUDGET REQUEST		ADD-ON REQUIRED FOR RESTORATION TO FY 85 LEVEL.		RECOMMENDED BASELINE FOR FY 86 APPROPRIATIONS		NTEU RECOMMENDATION		NTEU RECOMMENDED AUTHORIZATION	
	(000) Amount	Avg. Positions	(000) Amount	Avg. Positions	(000) Amount	Avg. Positions	(000) Amount	Avg. Positions	(000) Amount	Avg. Positions
Inspection and Control	298,305	6,225	+19,205	+351	317,510	6,576	+17,480	+400	334,990	6,976
Tariff and Trade	147,370	3,085	+20,070	+437	167,440	3,522	+7,965	+150	175,405	3,672
Tactical Interdiction	101,547	1,806	+4,226	+60	105,773	1,866	+2,110	+50	107,883	1,916
Investigations	91,880	1,415	+3,139	+39	95,019	1,454	+2,895	+50	97,914	1,504
SUB-TOTAL	639,102	12,531	+46,640	+887	685,742	13,418	+30,450	+650	716,192	14,068
Operation & Maintenance, Air Interdiction Program	60,425		-0-	-0-	60,425	-0-	-0-	-0-	60,425	
TOTAL	699,527	12,531	+46,640	+887	746,167	13,418	+30,450	+650	776,617	14,068

TABLE 4

U.S. CUSTOMS SERVICE
Average Positions
by Category
FY 1972 - 1986

Fiscal Year	Inspectors	Import Specialists	Patrol Officers	Agents	Total Customs
1972	3,184	1,312	485	853	11,116
1973	3,472	1,304	736	956	11,772
1974	3,693	1,208	971	532	11,878
1975	3,803	1,262	1,152	582	13,076
1976	3,873	1,256	1,191	614	13,380
1977	3,943	1,204	1,365	603	13,228
1978	4,077	1,207	1,251	600	13,854
1979	4,174	1,236	1,211	577	14,061
1980	4,165	1,219	1,231	604	13,820
1981	4,379	1,165	1,332	597	13,316
1982	3,987	1,081			12,924
1983	4,122	1,027	1,134	701	12,898
1984	4,289	1,042	1,246	932	13,319
1985	4,372	1,023	1,246	1,009	13,418
1986 (ADMIN)	4,166	766	1,246	1,009	12,531
1986 (NTEU)	4,772	1,173	1,296	1,059	14,068

Source: U.S. Customs Service Budgets

TABLE 5

U.S. CUSTOMS SERVICE

Formal Entries of Merchandise and Number of Import Specialists

Fiscal Years 1972-1986

Fiscal Year	Number of Import Specialists	Number of Formal Entries Of Merchandise (000)	Workload Entries Per Import Specialist	Average Annual Workload Growth	Productivity Per Import Specialist	Required Number of Import Specialists
1972	1,312	2,866	2,441			1,312
1973	1,304	3,240				
1974	1,208	3,206	2,650	1956-1974 4.3%	2,650	1,208
1975	1,262	3,015		1976-1986 11.7%		
1976	1,256	3,264				
1977	1,204	3,690				
1978	1,207	4,017				
1979	1,236	4,384	3,547			
1980	1,219	4,374	3,588			
1981	1,165	4,588	3,938			
1982	1,081	4,753	4,397			
1983	1,027	5,314	5,174*		3,676	1,446
1984	1,042	6,421	6,162*		3,790	1,694
1985	1,023	6,742	6,590*		3,903	1,727
1986 (EST)	766	7,079	9,241*		4,017	1,762

TABLE 5. CON'T.

NOTES:

1. Subcommittee on Trade, Committee on Ways & Means, Background Materials on H.R. 9220, July 14, 1976, p. 39, gives Import Specialists workload in FY 1974 and average annual growth of workload, 1956-1974. Workload is measured in number of entries per Import Specialist.

2. Bypass instituted by Customs, meaning 50-60 percent of entries are not reviewed by Import Specialists but are processed by clerical personnel.

3. Number of entries each Import Specialist is, on average, capable of processing, assuming 4.3% per annum productivity growth since 1974.

4. Assuming 4.3% productivity growth per annum since 1974, the number of entries each Import Specialist would be capable of handling in 1986 would be 2,650 + (2650 x .043x12) = 4017. Dividing this into 7,079,000 entries yields 1,762 as the required number of Import Specialists.

WORKYEARS
NOW

	AIR	LAND	SEA	PRECLEARANCE	TOTAL
INS Primary	258	465	74	63	973
Customs Primary	463	638	47	124	1272
TOTAL	631	1106	121	187	2245
INS Secondary	154	330	30	30	544
Customs Secondary	186	426	12	67	691
TOTAL	340	756	42	97	1235
GRAND TOTAL	1171	1862	163	284	3480

WORKYEARS
AFTER

	AIR	LAND	SEA	PRECLEARANCE	TOTAL
INS Primary	—	1106	—	63	1169
Customs Primary	631	—	121	124	1076
INS Secondary	154	330	30	30	544
Customs Secondary	186	426	12	67	691
TOTAL	1171	1862	163	284	3480

FTE's ADDED OR (LOST)

	AIR	LAND	SEA	PRECLEARANCE	CHANGE	CURRENT FTE's	GRAND TOTAL
INS Primary	(365)	+638	(74)	—	+196	973	1169
Customs Primary	+365	(638)	+74	—	(196)	1272	1076
INS Secondary	—	—	—	—	—	544	544
Customs Secondary	—	—	—	—	—	691	691
TOTAL	—	—	—	—	0	3480	3480

INS increases from 1517 FTE's to 1713
Customs decreases from 1963 to 1767

TABLE 7

SUMMARY OF CUSTOMS RESOURCE REQUIREMENTS, COSTS, AND ADDITIONAL REVENUE FROM INTENSIFIED COMMERCIAL FRAUD COMPLIANCE PROGRAM IN FY 1986

ENFORCEMENT LEVEL	ADDITIONAL MERCHANDISE ENTRIES TO BE PROCESSED	ADDITIONAL REVENUE YIELD ($ MILLIONS)	ADDITIONAL COMMERCIAL CARGO PROCESSING POSITIONS REQUIRED	CONSISTING OF:[1] CUSTOMS INSPECTORS	IMPORT SPECIALISTS	SPECIAL AGENTS	TOTAL COST[2] ($ MILLIONS)	NET REVENUE YIELD ($ MILLION)
I	650,000	780	800	600	175	25	32.2	748
II	975,000	1,170	1,200	900	260	40	48.4	1,121
III	1,300,000	1,560	1,600	1,200	350	50	64.5	1,495

[1] Commercial cargo processing resources in the total force are approximately in the ratio of 3,000 inspectors to 1,000 import specialists to 127 special agents assigned to fraud. Using the ratios of 3:1 : .13 yields the numbers in these columns.

[2] Computed at $40,000 per inspector and import specialist staff year, and $50,000 per special agent staff year, including recruitment, equipment, and training.

TABLE 8

COMPUTATION OF ADDITIONAL RESOURCE REQUIRMENTS AND REVENUE YIELD FOR INTENSIFIED COMMERCIAL FRAUD COMPLIANCE PROGRAM, FY 1986

FORMAL ENTRIES OF MERCHANDISE (000)	BY-PASS RATE [1]	ENTRIES TO BE REVIEWED (000)	NUMBER OF ADDITIONAL ENTRIES REVIEWED (000)	MARGINAL REVENUE COLLECTION PER ENTRY [2]	ADDITIONAL REVENUE YIELD FROM REVIEW OF ADDITIONAL ENTRIES ($ MILLIONS)	NUMBER OF ENTRIES PER AVERAGE COMMERCIAL CARGO PROCESSING POSITION [3]	ADDITIONAL AVERAGE POSITIONS REQUIRED TO PROCESS ADDITIONAL ENTRIES
6,500	60%	2,600	650	$1,200	780	800	800
6,500	50%	3,250	975	$1,200	1,170	800	1,200
6,500	45%	3,575	1,300	$1,200	1,560	800	1,600
6,500	40%	3,900	1,625	$1,200	1,950	800	2,000
6,500	35%	4,225	1,950	$1,200	2,340	800	2,400
6,500	30%	4,550					

[1] By-pass is the rate established for entries not to be reviewed by an import specialist. Commercial fraud enforcement levels can be expressed in terms of a decreasing by-pass rate.

[2] See Table 7. $1,200 is selected as a conservative estimate.

[3] See Table 4 for derivation. Commercial cargo processing positions include inspectors, import specialists, and special agents assigned to fraud.

TABLE 9. U.S. CUSTOMS SERVICE

PROCESSING COMMERCIAL CARGO -- FORMAL ENTRIES PER AVERAGE POSITION

FISCAL YEARS 1979 - 1986

FISCAL YEAR	NUMBER OF FORMAL ENTRIES OF MERCHANDISE	CARGO PROCESSING STAFF POSITIONS		TOTAL	FORMAL ENTRIES PER POSITION
		CARGO INSPECTION	TARIFF AND TRADE		
1979	4,384,000	4,174	4,170	8,344	525.4
1980	4,374,000	4,165	4,082	8,247	530.3
1981	4,588,000	4,379	3,837	8,216	558.4
1982	4,753,000	3,987	3,748	7,735	614.4
1983	5,314,000	4,122	3,595	7,717	688.6
1984	5,700,000	4,289	3,572	7,861	725.0
1985	6,100,000	4,365	3,572	7,937	768.5
1986	6,500,000				791.6*

* Projected at 3% productivity growth over 1985. Result is that in FY 1986 customs will have the capability of handling approximately 800 formal entries per average position in cargo processing.

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TABLE 10

AVERAGE U.S. CUSTOMS REVENUE COLLECTION PER FORMAL MERCHANDISE ENTRY

FY 1979 - 1984

FISCAL YEAR	TOTAL REVENUE COLLECTION ($000)	TOTAL MERCHANDISE ENTRIES (000)	AVERAGE REVENUE COLLECTION PER ENTRY ($)
1979	8,460,479	4,384	1,930
1980	8,230,100	4,374	1,882
1981	9,197,222	4,588	2,005
1982	9,981,342	4,753	2,100
1983	9,784,959	5,314	1,841
1984	11,678,238	5,769	2,024

TABLE II

FORMAL ENTRIES BY TYPE, COMPARED TO BY-PASS RATES
FY 1983 - 1986

FISCAL YEAR	TOTAL FORMAL ENTRIES (000)	DUTIABLE ENTRIES (000)	PERCENT OF TOTAL 1	TRADE PROGRAM ENTRIES (000)	PERCENT OF TOTAL 1	BY-PASS RATE 2 (%)	ENTRIES REVIEWED (NOT BY-PASSED) (000)
1983	5,314	3,720	70	2,179	41	50	2,657
1984	5,700	3,990	70	2,337	41	50	2,850
1985	6,100	4,270	70	2,501	41	60	2,440
1986	6,500	4,550	70	2,665	41	60	2,600

1. Actual FY 1983 data is extended to FY 84-86. Percentage of totals add up to more than 100 percent because of overlap between dutiable and trade program entries.

2. This is the percentage of entries not designated for import specialist review. By-pass procedures were established by customs because entry growth exceeded staff capability. At 60% by-pass, customs is barely applying enough resources to review trade program entries, and a substantial number of dutiable entries will not be reviewed.

TABLE 12

ESTIMATES OF AVERAGE AND MARGINAL REVENUE COLLECTION FOR U.S. CUSTOMS SERVICE

FY 1986

BY-PASS RATE	AVERAGE REVENUE PER ENTRY FACTOR[1]	MARGINAL REVENUE PER ENTRY FACTOR[2]	AVERAGE REVENUE COLLECTION PER ENTRY	MARGINAL REVENUE COLLECTION PER ENTRY
60	1.0	.9	$2,000	1,800
50		.8		1,600
40		.7		1,400
30		.6		1,200
20				
10				

1 The task is to estimate the marginal rate of return as the by-pass rate is reduced below 60%, that is, as additional entries are reviewed by import specialists. It is conservatively assumed that the marginal revenue is less than the average revenue. However, in the range between 60% and 30% by-pass, it is assumed that marginal revenue will remain high relative to average revenue, because dutiable imports are being by-passed.

2 A factor of .9 means that marginal revenue is .9 times average revenue, and so on.

Senator ABDNOR. Thank you very much.

I am sure you are aware that we do have—have you been before the Budget Committee?

Mr. TOBIAS. Yes.

Senator ABDNOR. We will see what happens, because whatever they come up with will be our guideline. As you get to budget meetings around here—nothing works out like it is supposed to. We bought some expensive equipment and machinery which were going to help us catch up on different things but it doesn't seem to work out that well, but we will take a hard look. We have a difficult task in front of us. We have heard a lot of requests this afternoon.

Mr. TOBIAS. We think, Senator, in this case, what we are talking about is a guaranteed production of revenues. So it is not a situation where we are asking for more money for more bodies without a guaranteed yield. In both agencies we can show how more people yield more money. We are talking about a method and an approach by attacking the deficit by spending, for example, if the Internal Revenue Service spent $174 million on salaries with a yield of $2.6 billion—there is no dispute over the figures. We are not talking about blown up figures in an attempt to get more people. These are proven figures, proven statistics, proven results. We think it makes sense to attack the deficit in this kind of way, by putting people out there that can bring more revenue in.

It would be sort of like a corporation that knew that it had 100 sales out there if it could hire 100 salesmen and instead it hired 50 salesmen and let the other 50 go by the wayside. We do not think that is good business and not good for the taxpayers.

Thank you very much.

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

STATEMENT OF H. WAYNE HOWELL, PRESIDENT

Senator ABDNOR. Our next witness is Wayne Howell.

Mr. HOWELL. Thank you. It is a pleasure to be here to testify. It is a pleasure to testify before the Treasury Subcommittee in regard to the fiscal year 1986 budget for the Internal Revenue Service.

My name is Wayne Howell and I am director of the Georgia Securities Division. However, today I am testifying as president of the North American Securities Administrators Association, a 67-year-old association that represents the State securities administrators in all 50 states, Canada, Mexico, and Puerto Rico.

You might ask why we are interested in the IRS budget but we do have a very good interest, even though it is remote in certain respects. The Internal Revenue Service deals in money, fraud and abuse, and particularly this relates to the tax shelter areas that we work very, very closely on. I am talking about abusive tax shelters. NASAA has issued an alert on this subject.

When you look at the history of tax shelters and the IRS approach to them you will find we were dealing in the past with primarily what we

call the fat cats. However, we are seeing now in the abusive tax shelter area a decline in the people who are dealing in these abusive tax shelters, reaching down to the low- and middle-income America. This causes all kinds of problems. We see the problems from the disclosure aspect and the fraud aspect. Internal Revenue sees it from the revenue aspect.

When you are dealing with the low- and middle-income investors, they get a double whammy from both sides. They are convinced by the fast talking con artist to pull their tax returns or the money generated from tax refunds, put it into these phony tax shelters. Then when they turn around the tax shelter promoter is gone. Then the IRS comes in and collects the taxes. They catch it from both sides.

Several months ago, in fact November 1984, we took a multistate enforcement action against a tax shelter operation that had 274 investors in 18 States. Our investigation revealed over $10 million in what appeared to be questionable investment tax credits and deductions. We worked closely with the IRS and will continue to work closely with them.

We see two different catagories. First is the take the money and run, where they simply sell the fraudulent investors, give the tax shelter aspects which are very abusive and then they take off and are not to be found. Then we have the illusion aspects, where they have a dry hole where they didn't even drill. They report it as being dry and get the deduction. We also see that in general mining. Where they go in, if they hit, they take the credit. If they don't, they charge it to the investors.

The investors are catching it from both sides. They are catching from the fraud perpetrated on them by the promoters and then having to pay penalties and interest to the IRS.

However, we have seen in the last couple of years we have seen a remarkable turn around in the IRS. The tax shelter area probably had the most market effect on tax shelter promotions of anything we have seen. Now working in cooperation with the IRS State securities administrators and the SEC are working to stamp out the tax shelter abuse. The decline we see in abusive tax shelters we think is directly attributable to the tax shelter registration.

We are also pleased to hear the remarks of Commissioner Eggers, to hear the emphasis now being placed other than on examinations, fraud, and tax shelters. We need to devote more resources and these pay off in real money. The IRS is doing a remarkable job with the resources they have.

We would like to recommend to the subcommittee that in particularly the tax shelter area, it be given emphasis and I think it will help to show that any investment made in this particular area of the IRS will be returned manyfold.

PREPARED STATEMENT

I will be glad to answer any questions. I have submitted a full statement for the record that we are in support of the IRS budget in this regard and will welcome the opportunity to come here and tell you this.

Senator ABDNOR. Thank you, Mr. Howell. Your entire statement will be made a part of the record. We appreciate you bringing this to our attention.

[The statement follows:]

STATEMENT OF H. WAYNE HOWELL

The North American Securities Adminsistrators Association (NASAA) appreciates the opportunity to appear before this Subcommittee in connection with hearings on the proposed Internal Revenue Service (IRS) budget for fiscal year 1986. My name is Wayne Howell. I am President of NASAA and Director of the Georgia Securities Division. NASAA is a 67 year-old association of the 65 state and provincial securities administrators from the United States, Canada and Mexico. Individually, we are charged with the responsibility for administering and enforcing securities laws in our various jurisdictions. NASAA works to maintain the integrity of the securities markets, to protect investors, and to prevent and curb abusive practices.

At first glance, the community of interest between the IRS budget and state securities laws must seem remote. Allow me to explain that community of interest. "Tax shelters," as that term is loosely used, implies devices to lawfully minimize, defer, or reduce one's tax liabilities. Abusive tax shelters, as that term is commonly used, implies devices which seek to reduce tax liabilities through business entities with little or no economic substance or business purpose, by the use of questionable claims of tax deductions or credits. The majority of all tax shelters, abusive or not, are fractionalized and sold to individual investors. These devices, usually partnerships or limited partnerships, are of concern to the IRS for their tax practices and of concern to state securities regulators for their securities practices. Both the IRS and the state securities regulators deem abusive tax shelters to be a chronic problem that is growing at an alarming rate. Recently, the IRS has declared abusive and illegal tax shelters as its top enforcement priority. NASAA has recently released a major investor alert regarding abusive tax shelters. The General Accounting Office estimates that abusive tax shelters rob the Treasury of $3.6 billion per year.

Tax shelters used to be a device only for the highest tax bracket taxpayer -- in short, a device for the sophisticated and wealthy. Recently, however, we have seen tax shelters mass marketed to factory workers, school teachers, truck drivers and bank tellers. Why are tax shelters being marketed to the middle class? It's simple -- they are less sophisticated and more vulnerable to the "BIG LIE."

On November 19, 1984, NASAA announced its multistate action taken against a nationally promoted abusive tax shelter which involved 274 investors in 18 states with over $10 million in income tax credits and deductions. Pitched to middle-income investors, the American TV or Vitagram shelter involved the production and distribution of videotapes of song and dance segments for television variety programs. Promotors claimed that participants who paid as little as $2,500 in state and federal income taxes could, over three years, recapture those taxes and wipe out their tax liability in subsequent years. State securities regulators have charged the shelter promoters with registration violations, misrepresentation of tax benefits, misrepresentation of the value of the product and omission of key facts.

Abusive tax shelters typically take one of two forms:

(1) "Take the Money and Run" -- Funds are raised from investors, and are to be used on a future tax shelter venture. However, the promoters simply take the money and run. This form, which I shall refer to as "Take the Money and Run," is a securities fraud and a tax evasion as the promoters generally run hard enough or far enough so that they don't pay taxes on their ill gotten gain.

(2) "Illusion" -- Funds are raised from investors for the purpose of developing a mineral deposit - it could be coal or oil and gas. Thereafter, the venture fails -- the inves-

tor takes his write-off and recovers part of his investment through tax savings. However, what really happened was that the promoters never attempted to exploit the mineral deposit. The promoter simply took the money and reported to the investors and the IRS that the "well was a dry hole." In fact, the oil well was never drilled. Let's refer to this form as the "Illusion."

There are several variations upon the "Illusion." One is to promote mining on a property that is known to have no coal. Another is to promote drilling for oil and gas in a general area, but not on a specific property. The idea here is if I hit it big, then it was my well, not the well of the investors' partnership. If I miss, then the well was the one being drilled for the investor partnership ("Heads I win, Tails you lose").

In looking at these typical abusive tax shelters, one must appreciate that the unsuspecting taxpayer gets caught with a double whammy. First, he has lost his investment and, second, his deductions and credits may be properly disallowed resulting in the assessment of additional taxes plus possible penalites and interest. The investor further has the problem that the IRS can readily find him, but neither he nor the IRS can find the promoter -- who arguably has the books and records. The taxpayer is left without any evidence to support his claimed deductions and credits except the Form K-1 which he received from the promoter.

At the state securities level, we are able to effect some investor protection. Upon close questioning, promoters will withdraw their application to sell securities in a state. Citing reasons of inadequate disclosure, misleading disclosure, questionable projections, and excessive markups, state securities regulators in Massachusetts, Pennsylvania, North Carolina and South Dakota were able to attain withdrawal notes in excess of 10% for private shelter offerings. Yet the state securities

regulators only see those offerings that are filed and many are not filed with us. Further, we do not have the capabilities of examining promoters who sell in our state but are located in another state. We need the help of the IRS.

Because of our concern about the proliferation of the tax shelter industry, we have met with officials from the Treasury Department and the Joint Committee on Taxation to discuss federal and state efforts to prevent the promotion of abusive tax shelters. Efforts are underway to develop cooperative federal - state methods for early identification of such shelters.

We are pleased by the remarks of Commissioner Egger before this Subcommittee and to note the increased emphasis being placed upon examination and fraud investigations of abusive tax shelters in the Proposed Budget. We wholeheartedly support the FY 1986 Budget Proposal of the IRS and are heartened by the proposals for FY 1987 through FY 1989.

Being familar with the securities industry, where strict recordkeeping and procedures are demanded, I would like to close with an observation about business operations. In our free enterprise system we place a lot of emphasis on "honor". However, businesses that are operated on "the honor system," wherein customers are trusted to pay what they owe, universally do not fare well.

What would your reaction be, as the owner of a business, if your Management operated your business as follows:

(1) Customers can enter and leave the warehouse with goods as they need them.

(2) The customers will make out their own invoices.

(3) The customers will pay those invoices if they choose to on a given date, but if they elect not to, then the customer can pay later and pay some interest.

(4) The internal auditors of the business will check 100% of the invoices for math errors, but resources restricts them from checking more than 1% of the invoices to see if the

quantity of goods reported on the invoices is the actual quantity taken. Of the invoices checked, a sizeable proportion showed substantial errors. On the average, each auditor produced almost $500,000 in additional revenue per year.

If I owned that business, I would be very upset because I did not provide my Collection Division with the necessary resources to collect the due and just debts to my company.

Let me leave you with the thought that could it be that:

1. The business is America
2. The invoices are federal income tax returns
3. The Collection Division is the IRS and the internal auditors are their agents. Do we want to continue to look the other way when one of the major methods of reducing our federal deficit is to fund the IRS at a level that will allow them to collect the taxes due out government. **** THANK YOU ****

Senator ABDNOR. Tax shelters have been a concern of mine too. It is worse in some areas than others.

A couple of years ago I went up to Alaska for some hearings and I saw some tax shelters that made my head spin.

Mr. HOWELL. I think the one thing I can say here today is the cooperation we are seeing today between the IRS and the state securities administrators is admirable. When I left Atlanta today at lunch time, there was an IRS agent in my office going over our records of registrations. This is something we have not seen in the past and it is encouraging.

Senator ABDNOR. It will be interesting to see if everyone interested in tax reform will make it easier for us to stay on top of tax shelters. Some may be eliminated, if we believe everything we read in the papers.

Mr. HOWELL. The illegal and abusive ones are the ones I was referring to. There are legal tax shelters that serve a very good purpose.

Senator ABDNOR. We appreciate your testimony very much.

AMERICAN ASSOCIATION OF RETIRED PERSONS

STATEMENT OF COL. W.K. BENSON

ACCOMPANIED BY:

DAVID AFFELDT, LEGISLATIVE CONSULTANT
WILLIAM CANUP, MANAGER, TAX AIDE

Senator ABDNOR. Colonel W.K. Benson, we welcome you and ask you to introduce your colleagues for the record.

Your entire statement will be made a part of the record.

Mr. BENSON. Thank you, Mr. Chairman.

The American Association of Retired Persons once again welcomes the opportunity to testify before the Treasury, Postal Service, and General Government Appropriations Subcommittee.

Our remarks will be brief and focus primarily on continuing the funding for the Tax Counseling for the Elderly Program for 1986. Additionally, we shall discuss the need to continue funding for the postal subsidy for private nonprofit organizations.

At the outset, the association wishes to commend the subcommittee for its support, particularly the decisions to fund TCE at $2 million for the past 2 fiscal years. Full funding has alleviated the need to return to the subcommittee for additional appropriations to reimburse program volunteers for their out-of-pocket expenses in the tax counseling season just completed.

The administration's budget recommends the same $2 million figure for TCE for fiscal year 1986. This funding would continue to be available for the reimbursement of volunteer out-of-pocket expenses and other program costs. We urge the subcommittee to continue to fund TCE, at a minimum, at $2 million for 1986. Current budgetary restrictions impose a duty on programs such as TCE to live within the limit imposed by the administration and Congress, if at all possible. However, the funding for TCE should be viewed against a backdrop of rising program costs because of expanding numbers of counselors volunteering and applicants to be served.

The legislative history of this measure makes it clear that Congress intended the funding for the program to provide services for additional elderly taxpayers because the number of older Americans is increasing dramatically. The program, owing to its rapid expansion since 1980, has achieved a degree of acceptance in the elderly community that assures continuing increases in applicants for the service in the future.

As a result of the $2 million appropriations passed by Congress for TCE in fiscal year 1985, the association's Tax Aide/TCE Program received a total contractual arrangement of $1.777 million. This money is being expended for increased program needs reflected in current tax counseling season activities. Nearly all of the funding goes to defray the out-of-pocket expenses of Tax Aide/TCE volunteer coordinators, instructors, and counselors. The $1.777 million allocation for the current year must be measured against the increasing numbers of elderly, handicapped, and shutin applicants currently seeking free tax assistance. There are clear explanations for this increased demand for service.

During the past 3 years, Congress has enacted major laws which have substantially changed the tax rules affecting aged and aging Americans. Many elderly are still not fully aware of these new provisions and how they affect their own tax situations. They come to Tax Aide/TCE sites in larger numbers in the tax counseling season just concluded seeking help to understand the tax changes and to have their income tax forms prepared free of charge. The Tax Aide/TCE Program, now in its 17th year, has virtually become institutionalized as a local service in communities coast to coast. The elderly, the handicapped, and shutins rely on this valuable assistance, performed by volunteer counselors whose motivation is the service they can perform for their fellow citizen. From 850,000 tax returns prepared or assisted in 1980, the service has grown to $1.3 million in 1984.

TCE provides a valuable service since IRS has repeatedly stressed that no taxpayer should pay more than is legally required. Experience shows that many elderly persons overpay their taxes each year or file when not required to do so. Some are confused by the tax forms. Others are unaware of available deductions, credits, and exemptions which were meant to benefit the elderly. The Tax Aide/TCE Program assists many catagories of inquirers, including those who need to file amended returns to claim deductions that were overlooked or to pay additional tax on income that was not reported.

The vast majority of Tax Aide/TCE clients have moderate or limited incomes. They are thus unable to afford the services of professional preparers for their routine returns. Those who do have complicated tax situations are advised to seek professional tax help in preparing their returns.

In recent years, the IRS has referred numerous taxpayers to the Tax Aide/TCE sites to receive assistance not always available at Government offices. This is due to the limited capabilities of some IRS offices to handle public inquiries because of budgetary constraints.

In addition, Tax Aide/TCE volunteer instructors cooperate throughout the country with IRS trainers to insure more intensive and comprehensive instruction of Tax Aide/TCE volunteer counselors. As a consequence, our counselors receive more in-depth instruction and frequently develop a better knowledge of the Tax Code. The result is better service for older Americans.

In conclusion, we reaffirm our support for a funding level of at least $2 million for TCE in fiscal year 1986. Without this amount, it would soon be necessary again to request additional funds to permit the Tax Aide/TCE Program to fulfill its obligations and promises to the volunteers who are incurring expenses in training and counseling activities.

TCE has been beneficial for our Nation's communities, the elderly, and the IRS.

It has increased taxpayer accuracy and compliance.

It has provided specialized, free service for groups traditionally underserved by the IRS, including minorities, the home-bound, and the rural aged.

And it has developed in our people a spirit of volunteerism which increasingly characterizes the attitude of the elderly toward their peers.

Thank you.

Mr. AFFELDT. I am David Affeldt, legislative consultant to the American Association of Retired Persons and on my left is William Canup, manager, Tax Aide.

Mr. Chairman, the association also urges the subcommittee to approve the fully authorized funding for the postal subsidy for private nonprofit organizations.

Congress provided this subsidy in recognition that private nonprofit organizations complement Government activities at all levels, Federal, State, and local. The harsh reality is that governmental units must increase public services if private sector activities would be reduced.

Over the years, nonprofit organizations have provided a considerable share of social, health, education, research, and other services. These services have assisted many persons in our society and without the necessity of seeking help from governmental programs. AARP, for example, offers diverse and comprehensive services for its 18 million members and the general public, including continuing education, housing, legal, and numerous other services.

Reduced postal rates have enabled private, nonprofit organizations to devote more resources to charitable, educational, and other beneficial activities for the public. We believe that it is sound national policy to promote these activities by the private sector through the establishment of reduced postal rates.

The rationale is even more compelling now because Federal spending for social programs has been cut markedly in recent years. Supporters of these reductions have often argued that the private sector should play a greater role in providing and delivering these services. However, the private nonprofit sector is unlikely to fill these gaps unless it has access to the mail system at a cost it can afford.

A substantial increase in postal rates will not only affect the ability of the private sector to deliver services by driving up operating costs, but it will also impede efforts to raise funds to carry out these activities.

AARP has reservations about the recommendation for the Postal Service to absorb future costs of the revenue forgone subsidy through cross subsidization from other mailers. As a practical matter, this change will require legislation. We have serious doubts that such a proposal could clear both the House and Senate in a form that could be sent to the President for his signature. The administration's proposal will surely encounter stiff resistance from both the Congress and the mailers who would be forced to pay higher rates.

The 1970 Postal Reorganization Act and subsequent amendments established a permanent funding mechanism for the continuing appropriation for the revenue forgone postal subsidy. This was designed to insulate nonprofit mailers from substantial hikes in mailing costs. The underlying philosophy for this measure was that postal rate increases for nonprofit mailers should be both moderate and predictable.

That philosophy made good sense then, and it does now, especially during a period when Federal support for services is diminishing while the public demand is either increasing or remaining essentially the same. For these reasons, we urge the subcommittee to support retention of the postal subsidy for nonprofit mailers.

Also, at this time I would like to add that we appreciate your support in the past for the tax counseling for the Elderly Program. This program has been able to flourish because of the support we received from members of the Senate's Treasury and Postal Service Appropriatons Subcommittee.

We thank you again.

Senator ABDNOR. Gentlemen, we thank you and want to commend you for the work you do on the Tax Counseling Program. It is absolutely essential and we will make sure that it continues.

I wish I could be as affirmative with you about that one as I can about the other, the revenue forgone. When we talk about $1 billion, we are talking about something different but we will see how it progresses on the floor.

We certainly thank you for the work you do for the elderly. I would like to take more time but we still have several more witnesses to go.

Mr. AFFELDT. We also want to thank you again for the very fine article which you had in one of your South Dakota newspapers about the Tax Program.

Senator ABDNOR. Thank you.

[The statement follows:]

STATEMENT OF COL. W.K. BENSON

The American Association of Retired Persons once again welcomes the opportunity to testify before the Treasury, Postal Service and General Government Appropriations Subcommittee.

Our remarks will be brief and focus primarily on continuing the funding for the Tax Counseling for the Elderly (TCE) program for 1986. Additionally, we shall discuss the need to continue funding for the postal subsidy for private nonprofit organizations.

A. Tax Counseling for the Elderly

At the outset, the Association wishes to commend the Subcommittee for its support, particularly the decisions to fund TCE at $2 million for the past two fiscal years. Full funding has alleviated the need to return to the Subcommittee for additional appropriations to reimburse program volunteers for their out-of-pocket expenses in the tax counseling season now under way.

The Administration's budget recommends the same $2 million figure for TCE for FY 1986. This funding would continue to be available for the reimbursement of volunteer out-of-pocket expenses and other program costs. We urge the Subcommittee to continue to fund TCE, at a minimum, at $2 million for 1986. Current budgetary restrictions impose a duty on programs such as TCE to live within the limit imposed by the Administration and Congress, if at all possible. However, the funding for TCE should be viewed against a backdrop of rising program costs because of expanding numbers of counselors volunteering and applicants to be served.

The legislative history of this measure makes it clear that Congress intended the funding for the program to provide services for additional elderly taxpayers because the number of older Americans is increasing dramatically. The program, owing to its rapid expansion since 1980, has achieved a degree of acceptance in the elderly community that assures continuing increases in applicants for the service in the future.

As a result of the $2 million appropriation passed by Congress for TCE in FY 1985, the Association's Tax-Aide/TCE program received a total contractual arrangement of $1.777 million. This money is being expended for increased program needs reflected in current tax counseling season activities. Nearly all of the funding goes to defray the out-of-pocket expenses of Tax-Aid/TCE volunteer coordinators, instructors and counselors. The $1.777 million allocation for the current year must be measured against the increasing numbers of elderly, handicapped and shut-in applicants currently seeking free tax assistance. There are clear explanations for this increased demand for service.

During the past three years, Congress has enacted major laws which have substantially changed the tax rules affecting aged and aging Americans. Many elderly are still not fully aware of these new provisions and how they affect their own tax situations. They are coming to Tax-Aide/TCE sites in larger numbers in the current tax counseling season (February 1 - April 15) seeking help to understand the tax changes and to have their income tax forms prepared free of charge. The Tax-Aide/TCE program, now in its 17th year, has virtually become institutionalized as a local service in communities coast-to-coast. The elderly, the handicapped, and shut-ins rely on this valuable assistance, performed by volunteer counselors whose motivation is the service they can perform for their fellow citizens. From 850,000 tax returns prepared or assisted in 1980, the service has grown to 1.3 million returns in 1984.

TCE provides a valuable service since IRS has repeatedly stressed that no taxpayer should pay more than is legally required. Experience shows that many elderly persons overpay their taxes each year or file when not required to do so. Some are confused by the tax forms. Others are unaware of available deductions, credits and exemptions which were meant to benefit the elderly. The Tax-Aide/TCE program assists many categories of inquirers, including those who need to file amended returns to claim deduc-

tions that were overlooked or to pay additional tax on income that was not reported.

The vast majority of Tax-Aide/TCE clients have moderate or limited incomes. They are thus unable to afford the services of professional preparers for their routine returns. Those who do have complicated tax situations are advised to seek professional tax help in preparing their returns.

In recent years the IRS has referred numerous taxpayers to the Tax-Aide/TCE sites to receive assistance not always available at government offices. This is due to the limited capabilities of some IRS offices to handle public inquiries because of budgetary constraints.

In addition, Tax-Aide/TCE volunteer instructors cooperate throughout the country with IRS trainers to insure more intensive and comprehensive instruction of the Tax-Aide/TCE volunteer counselors. As a consequence, our counselors receive more in-depth instruction and frequently develop a better knowledge of the tax code. The result is better service for older Americans.

In conclusion, we reaffirm our support for a funding level of at least $2 million for TCE in FY 1986.

Without this amount, it would soon be necessary again to request additional funds to permit the Tax-Aide/TCE program to fulfill its obligations and promises to the volunteers who are incurring expenses in training and counseling activities.

TCE has been beneficial for our nation's communities, the elderly and the IRS.

It has increased taxpayer accuracy and compliance.

It has provided specialized, free service for groups traditionally underserved by the IRS, including minorities, the homebound and the rural aged.

And, it has developed in our people a spirit of volunteerism which increasingly characterizes the attitude of the elderly toward their peers.

B. Revenue Foregone

Mr. Chairman, the Association also urges the Subcommittee to approve the fully authorized funding for the postal subsidy for private nonprofit organizations.

Congress provided this subsidy in recognition that private, nonprofit organizations complement government activities at all levels--federal, state, and local. The harsh reality is that governmental units must increase public services if private sector activities would be reduced.

Over the years, nonprofit organizations have provided a considerable share of social, health, education, research and other services. These services have assisted many persons in our society and without the necessity of seeking help from governmental programs.

AARP, for example, offers diverse and comprehensive services for its 18-million members and the general public, including continuing education, housing, legal, and numerous other services.

Reduced postal rates have enabled private, nonprofit organizations to devote more resources to charitable, educational, and other beneficial activities for the public. We believe that it is sound national policy to promote these activities by the private sector through the establishment of reduced postal rates.

The rationale is even more compelling now because federal spending for social programs has been cut markedly in recent years. Supporters of these reductions have often argued that the private sector should play a greater role in providing and delivering these services. However, the private nonprofit sector is unlikely to fill these gaps unless it has access to the mail system at a cost it can afford.

A substantial increase in postal rates will not only affect the ability of the private sector to deliver services by driving up operating costs, but it will also impede efforts to raise funds to carry out these activities.

AARP has reservations about the recommendation for the Postal Service to absorb future costs of the revenue foregone subsidy through cross subsidization from other mailers. As a practical matter, this change will require legislation. We have serious doubts that such a proposal could clear both the House and Senate in a form that could be sent to the President for his signature. The Administration's proposal will surely encounter stiff resistance from both the Congress and mailers who would be forced to pay higher rates.

The 1970 Postal Reorganization Act and subsequent amendments established a permanent funding mechanism for the "continuing appropriation" for the revenue foregone postal subsidy. This was designed to insulate nonprofit mailers from substantial hikes in mailing costs. The underlying philosophy for this measure was that postal rate increases for nonprofit mailers should be both moderate and predictable.

That philosophy made good sense then, and it does now--especially during a period when federal support for services is diminishing while the public demand is either increasing or remaining essentially the same. For these reasons, we urge the Subcommittee to support retention of the postal subsidy for non-profit mailers.

NATIONAL COORDINATING COMMITTEE FOR THE PROMOTION OF HISTORY

STATEMENT OF PAGE PUTNAM MILLER, DIRECTOR

Senator ABDNOR. Next we will hear from Page Putnam Miller.

Sorry to keep you waiting so long. I will blame everything on my staff here who arrange the listing of the names.

Ms. MILLER. Thank you.

I realize that it is getting late in the afternoon, so I will submit my statement for the record and would just like to summarize a few points for you.

I am here speaking today on behalf of historians and archivists. We want to thank you for your support over the years for the NHPRC Grants Program. This is a very small program and for the past 5 years it has been zeroed out in the President's recommendation for the budget, but Congress, each year, has seen that this program has been funded and we thank you for your support.

There are just four points that I would like to highlight for you now. First, is that we cannot afford to be a Nation without history, subject to every impulse and transient motion and the NHPRC is a very small program but an important one for promoting a greater understanding of our history.

Second point is that we are now approaching the bicentennial of the Constitution of the United States and NHPRC programs have supported many of the aspects of this part of our Nation. I think this is a time to support NHPRC.

A third point is that the NHPRC is a model of revenue sharing. The Federal Government provides seed money that is then matched and supplemented by private funds and most of the NHPRC programs are contributed to by grants from the Federal Government which is less than 50 percent of the whole project.

The last point that I would like to make, in urging a $5 million appropriation for the NHPRC Grants Program is that this money not be taken from the National Archives budget but that this be an amount on top of the proposed amount of $99.3 million that the President has recommended for the National Archives. The National Archives is already operating under very much of a bare bones budget. There is a great need for many of the deteriorating geneological records to be put on optical disks. There is really no money for this new program in the present budget.

There is a very large backlog of documents in the National Archives for which there are no funding aides. This means there is no intellectual control over these records and the Archives would like to be able to employ an additional 50 people. There is no money in the present budget for the hiring of those people.

And last, the National Archives is facing a space crunch. There simply is not room for the number of records that need to be deposited in the Archives. Many of them are thus staying in agencies at a very expensive storage costs.

For these various reasons, we feel it is most important that the NHPRC appropriation be on top of the present budget appropriated—recommended for the National Archives.

In closing, I would just like to thank you again for your support in the past of the NHPRC Grants Program and I would like to leave with you a report summarizing the records programs from the very beginning of this program to give you an idea of the kinds of projects that have been funded.

Thank you.

Senator ABDNOR. Thank you. Your needs are not that great, but we will have to see how it worked out. We commend you for the work you do and the group you represent. You have a lot of strong supporters in this Congress.

I am sorry to rush this along but we thank you for your attendance.

[The statement follows:]

STATEMENT OF PAGE PUTNAM MILLER

I am Page Putnam Miller, director of the National Coordinating Committee for the Promotion of History, a consortium of over 35 historical and archival organizations.

Mr. Chairman, on behalf of the over 50,000 members of the NCC organizations, I wish to express appreciation to you for your invitation to appear before this distinguished committee to give our views and to express our strong support of the National Historical Publications and Records Commission's Grants Program.

For the fifth consecutive year the administration's proposed budget recommends zero funding for this program. However, in past years the Senate has consistently gone on record supporting the excellent work of the NHPRC's Grants Program. In 1983 the Congress passed reauthorization legislation for this program and at that time Senator Ted Stevens asserted that "it is vitally important that we maintain and enhance our repositories of historical documents so that we may not lose sight of the rich history of our Nation."

A lack of concern for one's past and one's traditions is characteristic of individuals and societies, too busy to focus on anything but the activities of the moment. We cannot afford to be a land without history which is subject to every transient impulse and notion.

The $5 million appropriation which we seek for the Grants Program of the National Historical Publications and Records Commission is money well spent for the continuation and enhancement for a program dedicated to the preservation and publication of the documentary sources of our national history.

Mr. Chairman, it is legitimate to ask what the NHPRC has accomplished in the 35 years of its publications and the 11 years of its records program operations. Not only has the publication of the Founding Father's papers of Jefferson, Madison, Franklin, and Hamilton been commenced, but such important and diverse figures as social worker Jane Addams, and sculptor of the Lincoln Memorial, Daniel Chester French, have been included in the 405 sponsored volumes, 6,424 reels of microfilm, and 1,085 microfiches.

We are now approaching the bicentennial of the Constitution of the United States, and it is appropriate to remember the important role that the NHPRC has played in preserving our national heritage. As a result of the work of the NHPRC's Publications Grant Program, we now have or will soon have the documentary histories of the ratification of the Constitution, the first Federal Congress, and of the early Supreme Court. These publications recapture the ferment of ideas during the founding of our country and have special significance not only for scholars, but for many others including judges, Members of Congress, and Presidents, who regularly support and justify policy decisions by reference to the writings of our founders.

Besides the Documentary Editing Program, the NHPRC's other major component is a program focused on responsibility for care of records. The records portion of the NHPRC was established in 1975 and has played a crucial role in assisting public agencies, private institutions, and associations in all of our States to address critical records discovery and preservation programs. Many of our cities and counties, for example, have done little to manage and preserve their records. This circumstance is caused not so much by lack of interest as by lack of understanding about what can be done. During the past 4 years the NHPRC has awarded grants to 43 State historical records advisory boards to undertake assessment and reporting on State and local government records, historical records repositories, and statewide services and programs. These State assessment studies provide an important identification of priority problems and needs and recommendations for solutions. To cite one example, the Social Law Library in Boston has an NHPRC matching grant of $37,780 to arrange, deacidify, and buffer the valuable records of the Suffolk County Court of Common Pleas from 1699 to 1820. The 360,000 documents saved from destruction by the forces of time and nature reflect the work and interest not only of John and Samuel Adams, and Paul Revere but of the daily life and concerns of the citizens of colonial and early Federal Massachusetts.

Many NHPRC projects become models for the archival and records management professions for advancing important new techniques, management theories, and practices. The NHPRC program also serves as an exemplary model of the use of seed money to provide genuine leverage for eliciting funds from private sources. The with-

drawal of Federal funds, if allowed to take place, would mean the end of most Records and Preservation Programs, and the termination of more than one-half of the publications projects. Federal funds assure potential private sector backers that a project measured on a reliable nationwide standard is of significance and merit.

I do want to stress historians' and archivists' concern that funding for NHPRC be an additional amount above the proposed National Archives and Records Administration budget. The National Archives is facing many pressing problems which are not addressed by the proposed budget request of $99.363 million. Many frequently used and deteriorating genealogical records need to be transferred to optical disks to enhance the useability of the records while preserving them. A pilot study of the optical disk project will cost $3 million. Although the President's budget includes startup funds for a new preservation initiative more funds will be needed in the future. A recent study indicated that 84.5 percent of the textural records in the National Archives are in need of maintenance work to slow down deterioration. Intensive laboratory treatment is needed on four-tenths of 1 percent of the holdings and 4.6 percent require copying. Another area of concern is the lack of adequate finding aids for a large portion of records in the National Archives. To take care of a large backlog of undescribed records and to handle newly arriving records, 50 additional professional staff are needed. Perhaps the most pressing need now facing the National Archives is a shortage of storage space. For the past 10 years there has been much discussion of the need to acquire additional space. It is now overwhelmingly clear that there is a necessity for an National Archives Annex Building. Design costs, estimated at approximately $5 million, to begin work on this urgent problem are not included in the administration's budget proposal.

To put the exemplary NHPRC Grant Program in competition with the understaffed and underhoused National Archives for the same limited resources is to force the robbing of Peter to pay Paul. It would be a most unfortunate situation which would be harmful to both parties.

Mr. Chairman, on behalf of historians and archivists, and also on behalf of the American people's proud heritage and history, we recommend to this committee an appropriation of $5 million for the National Historical Publication and Records Commission's Grants Program.

COALITION TO SAVE OUR DOCUMENTARY HERITAGE

STATEMENT OF JOHN Y. SIMON

PREPARED STATEMENTS

Senator ABDNOR. Next is the Coalition To Save Our Documentary Heritage.

Mr. SIMON. Thank you, Senator. I have also prepared a statement and perhaps it would be preferable if I summarized it.

Senator ABDNOR. That will be fine. Both statements will be made a part of the record.

[The statements follow:]

STATEMENT OF JOHN Y. SIMON

Mr. Chairman and members of the committee, my name is John Y. Simon. I am editor of The Papers of Ulysses S. Grant and teach history at Southern Illinois University. I am speaking for the Coalition to Save Our Documentary Heritage, consisting of fifty-six organizations representing people across the country who truly care about history and therefore support adequate funding of the National Historical Publications and Records Commission.

This is the fifth time that the NHPRC has been omitted from the federal budget; each time the response has been broad and vociferous support for the Commission, in itself evidence of the value of this small but essential grant program. Strong bipartisan support for the Commission has prevailed, as it did eighteen months ago when Congress passed reauthorization legislation.

Since 1934, the Commission has provided national leadership in the preservation and dissemination of American historical documents, though without a staff until 1950. In 1964, the Commission received authority to make grants to assist in the publication of documents important to the study of American history; in 1974, Congress added records preservation to the Commission's mandate, embracing both records necessary to the government and those essential to public knowledge of the past.

Under current legislation, maximum funding for the coming fiscal year was established at $5 million, an increase of one million in the authorization level existing since 1974. A full five million dollars is needed to sustain efforts currently underway with only a small allocation to launch new endeavors.

Considering inflationary pressures since 1974, this modest increase from four to five million could be justified simply to maintain Commission projects. But new projects demand attention. The Commission has already approved the Dr. Martin Luther King edition, an important effort to preserve the words of this powerful leader while they still echo in our ears. The Commission should shortly receive a proposal to edit the legal documents of Abraham Lincoln, materials never before made available to scholars, vital to understanding the nature of his complex mind and providing the

additional benefit of clarifying the nature of the law in theory and practice in a midwestern state. These are mere samples of many worthy projects lining up for support; the small increase will ensure that only the most deserving will receive funding.

I believe that the Commission has been, and continues to be, a federal success story. The approaching bicentennial of the Constitution and the beginnings of our government will have no finer commemoration than the volumes that document the Ratification of the Constitution, the First Federal Election, and the First Federal Congress. No historical program delivers more for less money than that of the NHPRC.

The Commission has already been responsible for the publication of more than 400 volumes and more than 7,500 microforms. At least twenty-three publication projects have been completed, but some of the most vital of the approximately fifty in progress are long term in nature and run the risk of extinction if grant funding is eliminated. Comprehensive editions of the papers of Thomas Jefferson, Benjamin Franklin, and Jefferson Davis, for example, are necessarily voluminous; all these projects have proved their worth through volumes already published. If such projects were unworthy of federal support, the decision should have been made long ago, before the government had invested so much in the accumulation of documents from around the world and the assembling of skilled professional editors who have made these editions their life work.

With the support of the Commission, the Grant Association has completed fourteen volumes of The Papers of Ulysses S. Grant, covering the Grant correspondence through the Civil War. We could not have come this far without Commission funding, and without this support we cannot complete this work, taking Grant through his crucial role in Reconstruction, two terms in the White House, or his final struggle to write his Memoirs.

From the beginning of the grants program in 1964, the Commission has insisted upon additional support as one of the ingredients in the funding of every sponsored project; available figures indicate an average of 40 percent of NHPRC funding for sponsored projects. Because the Commission provides only partial support to publications projects and refuses to cover indirect costs, each proposal requires substantial private or insti-

tutional commitment, and this effective system of birth control enables the Commission to consider only proposals already judged worthy by others. Once funded, however, the Commission assumes responsibility for successful completion, a process that includes assisting each project to secure non-federal funding. Without an appropriation, more than just the federal funding would be lost. A carefully constructed public-private funding partnership would collapse.

A superficial glance at the number of private foundations in this country and their aggregate wealth might lead to the conclusion that important projects can obtain funding simply by asking. As one who has asked for more than twenty years, let me assure you that this is not true. So many foundations are restricted in purpose, limited by prior commitments, by geographical mandates, and in a wide variety of other ways, that the number capable of supporting long-term historical scholarship is small, and these foundations are besieged with worthy proposals. In the future, we should expect some private financing of NHPRC projects, but there is no realistic expectation that all major projects underway can be supported in this manner. Foundation support to supplement federal funding has been given <u>because</u> NHPRC projects have federal fiscal sponsorship; desperate attempts over the past five years to substitute private support for NHPRC funding have proved that this effort is impossible. In the case of the Grant Association, federal funding is necessary to maintain support from Southern Illinois University, which supplies 60 percent of the annual budget. Non-federal funding enhances and supplements the work of the Commission, but cannot serve as a reliable substitute for the sustained support necessary to complete mammoth undertakings.

The goal of each edition is an accurate rendition of words put on paper by important Americans. The development of modern historical editing parallels professional art restoration in embodying the highest respect for the original, adopting a minimal approach to making this material accessible to a modern audience, and ensuring that it will exist in the future. Even preservation of a manuscript does not necessarily mean availability of its words and meaning. As a teacher, I help history graduate students decipher the handwriting of the nineteenth century, constantly reminded of how diff-

icult this task is for persons without advanced training. Many documents vital to understanding the past need professional reading and transcription to establish their text. Some will not receive it. Each year more irreplaceable manuscript material is lost through the ravages of time: by flood, theft, fire, vandalism, or simply deterioration through neglect.

All editions sponsored by the Commission rely upon documentary sources, dependent in turn on the preservation and dissemination of records. Records advisory boards in the states enable the Commission to assist and to advise public agencies in identifying and preserving vital historical records in accordance with modern archival technique. There is no expectation that the Commission will supply the funds needed to preserve and maintain records. Instead, the Commission sponsors pilot programs to identify, preserve, and disseminate selected groups of documents to serve as models elsewhere. The recent successful completion of a series of statewide record assessments points the way to action in many states, throwing light into dark corners of neglect.

In Illinois, for example, this assessment has focussed attention on the scandalous condition of the archives of Chicago, establishing also that records long believed to have burned in the Great Chicago Fire of 1871 still exist. City agencies operating without retention and disposal schedules have created mountains of paper which defy mining to uncover the ore, scattered in storage facilities and inaccessible both to the originating agencies and to researchers. The report calls for the establishment of a professionally-staffed permanent depository in which crucial records will be available to city agencies and citizens alike. The Commission will not and need not finance this facility; when Chicago adopts modern archival and record-managing techniques it can realize savings by reducing inefficiency in retrieval and unnecessary storage cost.

Records grants support efforts to improve archival practices or to create new archives and archival networks. Non-traditional materials, such as photographic and machine-readable, have received special attention. Much-needed municipal records programs have assisted local governments in determining what to preserve and how to do so.

The Commission has held conferences on editorial technique and on technical subjects such as the production of microform materials. The Commission has been in the forefront in the creation of standards for microform publications and insists on high quality paper for all printed publications. The Commission has encouraged publications projects to employ new methods of publishing, using modern word processing and computer equipment to expedite massive projects while reducing cost.

The Commission, as a model agency, has used relatively little federal money to sustain major projects that draw on state and local funds and attract support from individuals and foundations. This limited federal funding is indispensable as a nucleus for additional funding, as an assurance that American history is a federal concern, and as a means of stabilizing budgets for projects of scholars and professional archivists who are neither grantsmen nor fundraisers. The NHPRC, in sum, has a successful program underway, modest in cost and highly productive. Funding is necessary to maintain projects that have already proved their worth and cannot be allowed to terminate without waste of funds already invested and loss to all Americans who care about their heritage.

COALITION TO SAVE OUR DOCUMENTARY HERITAGE

National Historical Publications and Records Commission
Funding Request
$5 million--FY1986

THE COALITION TO SAVE OUR DOCUMENTARY HERITAGE requests a $5 million appropriation for the grants program of the National Historical Publications and Records Commission (NHPRC) for the following reasons:

**This program effectively LEVERAGES THE FEDERAL DOLLAR--There is a tremendous payback in productivity for a small federal contribution.

**All grants for actual project costs. NO INDIRECT COSTS ARE ALLOWED AS GRANT EXPENSES.

**DECLINE IN PRIVATE FUNDING EXPECTED: Foundations and corporations may contribute on a short term basis but cannot provide the kind of long term stable funding needed.

**FUNDING HAS NOT INCREASED SINCE FY80--projects have experienced cutbacks and budgets will be further reduced if there is no increase in the NHPRC appropriation this year.

**NEED TO PREPARE FOR THE BICENTENNIAL--NHPRC projects are providing the documentary materials that for the basis for research on and understanding of our nation's early development.

NEW PROJECTS: The NHPRC staff have identified several major, national significant publications projects, which at present funding levels cannot begin.

**NEED FOR A GREATER FEDERAL CONTRIBUTION TOWARDS SOLVING OVERWHELMING RECORDS PRESERVATION PROBLEMS--The NHPRC's records grants program is conducting a valiant effort to provide assistance to state and local governments attempting to deal with problems of records preservation, inventory and disposal.

FACT SHEET

THE NATIONAL HISTORICAL PUBLICATIONS AND RECORDS COMMISSIONS GRANTS PROGRAM

BACKGROUND: For the past 5 years the funding level for the NHPRC's grants provided by the Appropriations Committees has been:

FY81 - $4 million
FY82 - $2.5 million
FY83 - $3 million
FY84 - $4 million
FY85 - $4 million

These appropriations have been made despite the fact that every Administration budget since FY82 has recommended that no funding be provided for this program. In 1983 Congress reauthorized this program and set the authorized funding level for FY86-88 at $5 million. The $5 million federal contribution would continue to provide for a modest effort to preserve and publish the documents relating to our nation's past while a continuation at $4 million would necessitate cutbacks..

PUBLICATIONS PROGRAM

*FEDERAL FUNDING FOR PUBLICATIONS HAS REMAINED STABLE FOR A DECADE: Historical documentary editing is a labor intensive profession. Most project employ an average 4-5 professional and support staff. Staff costs increased each year (but not at the rate that the cost of living was increasing), yet for a decade the same financial commitment has been made by the federal government. Thus, some projects have suffered a staffing decline, particularly if they have been unable to obtain additional support from their host institutions or other private sources.

*DECLINE EXPECTED IN PRIVATE FUNDING: Since 1981-82 period when Commission funding was first threatened, an intense effort to attract foundation and corporation funding has been mounted by publications projects. Projects that have received funding from private foundations (i.e. Founding Fathers [Madison, Jefferson, Franklin, Washington, and Adams] Consortium) during for past 4 years are finding that those foundations are unwilling to support the projects on a long term basis. Foundations and corporations are looking for short term results and corporations in particular are interested in recognition for their contributions ("this program is brought to you by Mobil Oil Corporation"). Documentary editing projects are both long term and low visibility, and therefore experiencing only limited success at raising private funds.

*NEW PROJECTS AWAITING FUNDING: The NHPRC has identified several nationally significant papers projects (for example: President Abraham Lincoln, Martin Luther King Jr., House Speaker Sam Rayburn?, General John Pershing). At the present level of funding, these projects will either not be begun or not be funded at an adequate level.

*BICENTENNIAL: The fact that Congress is interested in a significant national observance of the bicentennial of our nation's Constitution and the First Federal Congress is evidenced by the fact that Congress passed legislation to es-

tablish a commission that will plan the national celebration in 1983 and by the establishment of the Senate Historical Office and the House Bicentennial Office. Yet with the bicentennials of the Constitution, the Congress and the Court rapidly approaching, the projects publishing the documents relating to the founding of our nation are endangered. If NHPRC grant funding becomes unavailable, 4 projects--The Documentary History of the Ratification of the Constitution and the Bill of Rights, The Documentary History of the First Federal Elections, The Documentary History of the First Federal Congress (1789-91), and The Documentary History of the Supreme Court (1789-1800), projects--initiated by the NHPRC, would be forced to cease their work. If funding is continued at the present $4 million level, these projects will experience cutbacks in FY86, when they should be increasing their efforts to provide the published documentary centerpiece to the bicentennial celebration.

RECORDS PROGRAM

The Committee on the Records of Government, in its recently published report, states:

> The United States is in danger of losing its memory.
>
> Our Governments--federal, state, and local-- already have lost control of paper records. Existing federal paper records, if stored in a single line of three drawer filing cabinets, would stretch for a thousand miles. Buried within and currently unobtainable are the twentieth century counterparts of Madison's notes on the Constitutional Convention as well as the narrative of emancipated slaves collected by the Freedmen's Bureau.

The NHPRC's records grants program is conducting a valiant effort to provide assistance to state and local governments attempting to deal with problems of records preservation, inventory, and disposal.

The Commission is sponsoring a series of major studies in all states to determine the condition of historical records and the need for preservation. The first 27 report have been completed and 13 more are in progress. Already there is evidence of severe problems of preservation and continued public assess to records in county courthouses, state archives, and local historical societies. In the wake of these alarming reports,the Commission has undertaken a major assessment of conservation problems within state archives. The report, which is due in June, is expected to demonstrate the need for rapid action on a massive scale. Like the library world's problem of brittle, crumbling books, the archival world faces a potential nightmare of acid damaged paper, deteriorating photograph and architectural records collections, improperly stored or inaccessible computer tape and other machine readable records. The grants program cannot attempt to solve all of these problems, but it must provide, together with the National Archives, national leadership in the effort to coordinate an assault on this mountain of deteriorating records.

FACT SHEET
NATIONAL HISTORICAL PUBLICATIONS AND RECORDS COMMISSION FUNDING

BACKGROUND:

The National Historical Publications Commission was created with the National Archives in 1934, first given its own staff in 1951, authorized to make grants in 1964, and reorganized in 1975 as the National Historical Publications and Records Commission. NHPRC grants, budgeted at a maximum of $2 million before 1975, have not exceeded $4 million since the addition of the Records program. The NHPRC has an outstanding record of using Federal funds to stimulate private contributions to records preservation and publication projects. In spite of these achievements, every Administration budget since FY82 has recommended ZERO funding for the 21 year old grants program. Fortunately, constituent groups have worked to make the Congress aware of this program, and appropriations for the grants program have been included in the final continuing resolution each year. In FY83 and FY84, $4 million was appropriated for grants. Without the federal funding, the records preservation program would end and more than half of the publications projects would have to close down.

KEY POINTS:

NHPRC, through its publications grants, has helped to make available for broad public use many of the most important federal documents.

Unlike other federal grant programs, NHPRC grants never cover indirect costs.
NHPRC grants stimulate substantial matching contributions from private sources which will generally not be available if the federal participation is withdrawn.
Federal funds serve to assure potential backers that the project has genuine significance and is capably staffed and organized.
It is a model cost-sharing program that has supported many valuable projects.

Through its Publications Program the Commission:
Supports documentary editing projects, such as the Papers of Thomas Jefferson, the Documentary History of the First Federal Congress, and Freedom, A History. 405 sponsored volumes have appeared to date, as well as 6,424 reels of microfilm and 1,185 microfiches. Twenty three book editions and one hundred and forty seven film/fiche editions have been completed.
Plays a leadership role in editorial training and in setting overall standards for paper preservation and microfilm publication.
Makes documents, collected from a wide range of sources and published free from partisan interpretation, available to all those interested in American history and culture.

Through its Records Program the Commission:
Has partially funded records preservation projects at 450 institutions in 49 States, the District of Columbia and Puerto Rico.
Advises and assists state and local historical societies, archives, libraries and associations to ensure the discovery and preservation of historically valuable document collections.
Funds projects of national importance, such as manuals on archival techniques, research and development projects in historical photo preservation, appraisal studies for a wide variety of records, and needs assessment and planning in such areas as: police, labor, scientific, and technological records.

Mr. SIMON. My name is John Simon. I teach history at the Southern Illinois University and I am speaking for the Coalition to Save Our Documentary Heritage which is a group of some 56 organizations representing people across the country who are in support of history and consequently of adequate funding of the National Historical Publications and Records Committee.

The NHPRC has been zeroed five times and the amount of support it has received across the country and in Congress has been most gratifying and it testifies to the strength of this essential Grant Program.

Eighteen months ago Congress passed reauthorization legislation under which NHPRC is under a level of $5 million and we strongly urge that all $5 million be made available to this commission. It is an increase of only $1 million over the previous level, one that has been in place for some time. Under that level of funding, more than 400 volumes have been published and 7,500 micro forms.

But the strains are beginning to tell on the more than 50 projects sponsored by NHPRC, and there are a number of new projects that need support from this commission. One of them endorsed at the last commission meeting is an edition of Dr. Martin Luther King, a forceful and dynamic leader whose impact on American society is undeniable.

Another one that I anticipate will come before the commission soon is a project to collect, edit, and publish the legal papers of Abraham Lincoln. While the collected works of Abraham Lincoln have been available since 1953, the legal documents were excluded from that edi-

tion. They have been slowly gathered in Springfield, IL. They are ready for publication, and they ought to receive the enthusiastic support of this commission.

The commission will be receiving far more proposals than it could possibly support under a $5 million appropriation, and on the strength of that, I feel certain that only the most worthy will receive any funding from the commission. If projects do receive funding from the commission, they are likely to receive an average of 40 percent of their total budget. These projects must have institutional sponsorship and they must have some device for getting matching funds as well. This operates as a kind of birth control on projects. They must have firm support that puts them in contention for limited Federal funds.

Because they have been successful in achieving some private support, the question has been raised why they cannot be supported entirely by private funds and the answer is these funds are not available. Foundation funds are rarely available for long range projects. Some must necessarily encompass many years for their completion, and those foundations that support NHPRC projects normally do so because they have the backing of the Federal Government, not only moral but actually financial. The private funding that is put into these projects, and it is a considerable amount of money, is put into it because of Federal support.

At Southern Illinois University I teach history and I am not sure that we have the greatest graduate students in the world but I am not sure we have the worse either. I do know how often they go the original documents in the course of their research and they are simply unable to read them. There is a belief that if documents merely survive they need not be edited or published, but any experienced teacher can testify to the opposite. What is even more important is the vanishing supply of some of the more vital documents in American history, disappearing each year as they are eaten by mice, burned up by fires, trampled on the floor. If there is a new way to destroy a document, it will be utilized in the coming season. We can count on it. The Records Program of the NHPRC has been fighting again this tendency. It has identified endangered records. It has identified areas of neglect, and ignorance by records administrators and also some private hands.

In Illinois a State records assessment grant was instrumental in discovering a vast cache of the records of the city of Chicago, records that the city of Chicago had forgotten about, including records that the city thought had been burned up in the great Chicago fire of 1871. Nobody had located them since. They were scattered in warehouses all over the city at enormous cost to the city. They were unavailable both for the administration of the city or for any research purpose. This is one of the model records programs of NHPRC.

To identify the problem, to set it toward a solution and to create models of proper records management that will serve in many cases. It is not the intention of NHPRC to shift the enormous cost of maintaining records from the units involved to the Federal Government but

simply to show them how best to do it and when they find the best way to do it, very often they can find the money themselves by saving through records retention and disposal schedules.

The money that has been put in to NHPRC under the Grant Program since 1974 is in the perspective of the Federal Government a very small amount of money. As one of its recepients, I am very proud of what I have done with what money has been available and as one who has struck at private institutions for 20 years looking for an alternative, and not finding one, I assure you that this money is essential to the survival of our project and to most of the other of these 50 projects.

We are very proud of having accomplished what we have with modest funding. We hope that your support will continue.

I thank you very much.

Senator ABDNOR. I thank you very much. I need not tell you you have had a lot of support around here and appreciation for what you do and you should take pride in your accomplishments.

I can only say that the list of witnesses we have had have given us quite a challenge. The staff and I will have quite a time and a lot depends on what happens with the budget resolution. We know of your needs and the work you do. I better not be making any great promises but let me say we will give it close consideration.

Thank you.

ADDITIONAL PREPARED STATEMENTS

I would ask unanimous consent that a statement by Mr. James Peirce, president of National Federation of Federal Employees regarding the Office of Personnel Management be placed in the record at this point and a statement received from the National Association of Tax Administrators.

[The statement follows:]

44-565 0-85-32

STATEMENT OF THE NATIONAL FEDERATION OF FEDERAL EMPLOYEES

Mr. Chairman and Subcommittee Members: The National Federation of Federal Employees appreciates this opportunity to testify on fiscal year 1986 appropriations within the Subcommittee's jurisdiction. One of the issues of primary concern to us this year is the expiration of the ban on implementation of personnel regulations proposed by the Office of Personnel Management. Last year, a one-year prohibition on these regulations was included in the House version of the fiscal year 1985 Treasury Appropriation bill. However, the Senate version of the legislation did not contain similar language so during conference on the bill, a shortened prohibition was agreed upon. This ban is due to expire on June 30 of this year and unless it is extended, the OPM regulation will become effective. Because of the widespread disruption to the Federal workforce which the regulation changes could precipitate, it is imperative the Subcommittee extend the ban for fiscal year 1986.

On March 30, 1983 the Office of Personnel Management proposed new regulations governing civil service performance appraisals, within-grade pay increases, reduction-in-force procedures, and the scope of labor management contract negotiations. The regulations were a direct assault on many of the basic rights of Federal workers. Congress, on three separate occasions, legislatively barred OPM from implementing them. The current prohibition runs through June 30, 1985. OPM Director Don Devine has vowed to go ahead with the new rules as soon as the ban expires.

The Civil Service Reform Act of 1978 provides the statutory framework for the development and administration of Federal personnel regulations. Unfortunately, the Act is often vague, giving an incumbent Administration opportunities to interpret the law in a manner that may violate its intent. The new personnel regulations proposed by the Office of Personnel Management are a case in point.

The rules would adversely affect women and senior employees, drive fully capable employees out of Government, and would increase Government costs. Moreover, at a time when the current civil service performance appraisal system is widely discredited, the regulations would place greater reliance on it in decisions involving reductions-in-force and within-grade step increases.

At this time, I would like to summarize some of the worst features of the proposed rules.

The proposed regulations would change the system by which employees are ranked on retention lists. They would allow an extraordinary number of points to be awarded for performance above the fully successful level, permitting one employee to outscore another fully capable employee who may be 14 years his/her senior. Not only is there no explanation of why these extra points are needed, but OPM totally ignores the impact this will have on the budget.

For example, the new point scheme would increase the rate of layoffs among senior employees. These are the people who, if removed, will cost the government greater severence pay. They are also the employees who would have the greatest difficulty securing new jobs.

Finally, the new system is quite likely to have an adverse impact on the level of government expertise. For example, under the new point scheme a Nuclear Safety Specialist with the Nuclear Regulatory Commission with 15 years of fully successful experience could be let go in favor of an employee with only three years of experience simply because the latter employee performed outstandingly in his/her "training period" that exists in any career ladder occupation. Do we really want to favor outstanding "training scores" over a proven, tested, experienced worker?

The new rules would limit so-called "bump and retreat" rights to one or two grades and only within nonclerical jobs. This would signigicantly disadvantage women. If we assume that women nonclericals (i.e., professional and semi-professional employees) are more likely than men to have started as clericals, this new regulation robs them of one of the few advantages they now have of being able to retreat to that clerical job, if necessary.

The new rules stipulate that if an employee is rated "fully successful," he/she is merely eligible, not guaranteed, a within-grade step increase. This is a violation of law, since a step increase is required if the criteria are met. Thus, under the proposed rules, an employee's rightful increase could be denied for some unstated reason.

The proposed regulations mandate definitions of performance levels that are built on a peer or forced distribution concept. By using words such as "rare" and "unusually good," the rules seek to return to the pre-Civil Service Reform Act days when the government measured performance not against objective standards, but rather by peer group comparisons. Under the concept, a large work unit of poor performers would still merit one or two outstanding ratings because a certain level of performance could be rare, although not necessarily up to standard. Conversely, a group of superior performers cannot be properly rewarded. The Civil Service Reform Act required agencies to evaluate by objective standards not peer comparisons.

The Office of Personnel Management's proposed changes to existing personnel regulations would violate existing law, discriminate against women and senior employees, increase government costs, chase the more capable employees from government, and disregard merit principles. We therefore request that the Subcommittee continue the current prohibition on these regulation changes.

Statement of the National Association of Tax Administrators

The National Association of Tax Administrators expresses its appreciation to the Senate Appropriations Committee Subcommittee on Treasury, Postal Service, General Government for its invitation to submit the state tax administrators' concerns over the substantial reduction that has been proposed in the Bureau of Alcohol, Tobacco and Firearms' appropriation for cigarette law enforcement for fiscal year 1986.

The National Association of Tax Administrators is an organization of the tax agencies of each of the fifty state governments and the District of Columbia. Its principal membership is the tax commissioners and directors of revenue of the state tax agencies. These are the officials who have responsibility for the collection of state taxes and who serve as the principal tax advisors to the governors of the respective states. NATA includes within its organizational structure a Tobacco Tax Section (formerly the National Tobacco Tax Association) which holds annual meetings for administrators of state cigarette taxes.

At its meeting in December 1984, the Advisory Commission on Intergovernmental Relations completed an analysis of the evasion of state cigarette taxes. It concluded that cigarette smugggling has declined significantly since 1977, due in large part to the passage of the federal Contraband Cigarette Act in 1978 and the resulting enforcement efforts by the Bureau of Alcohol, Tobacco and Firearms, but that the removal of this federal enforcement presence could result in a resurgence of cigarette smuggling. It therefore recommended that Congress continue to fund the tobacco enforcement program of the Bureau of Alcohol, Tobacco and Firearms.

In support of this conclusion, ACIR said that ATF has made an important contribution in promoting more uniform law enforcement among the states, in coordinating interstate investigations, and in improving the training of state and local law enforcement personnel, but that a continuous federal law enforcement presence is needed to maintain the gains made against cigarette smuggling, to keep organized crime involvement in check, and to protect legitimate cigarette wholesalers and retailers.

The state tax administrators strongly support the conclusions of the Advisory Commission on Intergovernmental Relations study.

Since the passage of P.L. 95-575, the Contraband Cigarette Act, NATA has repeatedly adopted resolutions of support for an appropriation for the Bureau of Alcohol, Tobacco and Firearms, adequate to permit ATF's continuing presence in cigarette law enforcement. A copy of that resolution is attached. While the appropriation for fiscal year 1985 was apparently adequate, NATA is concerned that the announcement of an 80 percent cut in funding for this purpose for the 1986 fiscal year will send a signal to organized tax evaders that it is safe to resume their former smuggling activities.

The state tax administrators concerns about reduced enforcement are intensified by the numerous increases in state cigarette tax rates that have been enacted during recent years. Since January 1, 1982, legislatures in thirty states have increased their cigarette tax rates. Nineteen of these increases have been for 5 cents per pack or more. In addition, six states have enacted increases that will go into effect if the federal government fails to extend its current rate of 16 cents per pack.

These tax rate increases relate to the ATF appropriation for two reasons. First, they reflect the greater need for revenue by many states in recent years. Second, they accentuate the incentives for cigarette smuggling. The states with the lowest cigarette tax rates have refrained from increasing their taxes, while states with rates

in the middle and higher ranges have sought increased cigarette tax revenues.

Consequently, state cigarette tax rates now range from 2 cents per pack in North Carolina to 26 cents in Connecticut and Massachusetts. The total state and local tax rate in New York City is now 29 cents and the combined state, county, and city rate in Chicago is 35 cents.

This widened disparity in state cigarette tax rates creates a greater financial incentive for former smugglers to resume their tax evasion activities. As NATA has previously reported to the committee, bootleggers can return to their illicit activities with little notice. They require only a rented truck, a driver, and sufficient capital to purchase cigarettes in low tax states. Also there is concern that organized crime may bypass the need for capital by resorting to hijacking as a means for providing a cost-free source of supply for bootlegging cigarettes.

A sharp reduction in ATF's appropriation for cigarette law enforcement would suggest that cigarette smuggling is a nearly resolved matter. In actual fact, the need for the effective implementation of the federal contraband cigarette act has been accentuated in the past several years because of the circumstances which compelled the widening of the range of state cigarette tax rates.

Again, NATA expresses its thanks to the Committee for considering the state tax agencies' concerns in this important matter.

CONTRABAND CIGARETTE ENFORCEMENT

WHEREAS, Congress, through the enactment of P.L. 95-575, the Contraband Cigarette Law, took a major step in the reduction of cigarette bootlegging, and

WHEREAS, the lack of an appropriation for contraband cigarette enforcement may furnish the stimulus for a sharp revival in cigarette bootlegging, and

WHEREAS, such a development would result in a significant revenue loss to the states and would create serious law enforcement problems for state and local governments, and

WHEREAS, because of the wholly interstate character of cigarette bootlegging, the states could not compensate for the loss of federal assistance in this area, even with increased spending, now, therefore, be it

Resolved, that the National Association of Tax Administrators respectfully request the Administration and Congress to continue adequate funding to the Bureau of Alcohol, Tobacco and Firearms to maintain a federal presence in contraband cigarette enforcement to prevent a resurgence of interstate cigarette smuggling.

SUBCOMMITTEE RECESS

Senator ABDNOR. With that, I believe that completes our witnesses today. I thank you for participating in today's hearing.

As you will note, there is considerable concern about a number of accounts in this bill. It has not been an easy year for us. Your participation becomes all that more important.

If there is no further business to come before the subcommittee, we will stand in recess until Wednesday, May 1, at 2 p.m., when we will hear testimony from the General Services Administration.

We stand in recess.

[Whereupon, at 4:40 p.m., Tuesday, April 23, the subcommittee was recessed, to reconvene at 2 p.m., Wednesday, May 1.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

WEDNESDAY, MAY 1, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The Subcommittee met at 2:14 p.m., in room SD–138, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, and DeConcini.

GENERAL SERVICES ADMINISTRATION

OFFICE OF THE COMPTROLLER

STATEMENT OF RAYMOND A. FONTAINE, COMPTROLLER

ACCOMPANIED BY:

WILLIAM B. EARLY, JR., DIRECTOR OF BUDGET
WILLIAM F. SULLIVAN, COMMISSIONER, PUBLIC BUILDINGS SERVICE
DONALD C.J. GRAY, ASSISTANT ADMINISTRATOR, FEDERAL SUPPLY AND SERVICES
FRANK J. CARR, ASSISTANT ADMINISTRATOR, OFFICE OF INFORMATION RESOURCES MANAGEMENT
EARL E. JONES, ACTING COMMISSIONER, FEDERAL PROPERTY RESOURCES SERVICE

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order.

Today we continue our fiscal year 1986 hearings with testimony from the General Services Administration and the U.S. Park Service. I have no other comments.

Senator Mattingly?

Senator MATTINGLY. I have no questions but I do want to say it is a pleasure to see you here today. I used to see you when I was chairman of the Legislative Branch Subcommittee. Welcome back.

Senator ABDNOR. First, we will hear from Mr. Raymond Fontaine who is Comptroller of the General Services Administration, and I want to point out for the record that Mr. Fontaine is appearing as our main witness today because his office has provided the continuity at the GSA

during recent months. I am disappointed that GSA has gone for over a year now without an Administrator.

I want the record to reflect my thanks to Mr. Ray Kline for his leadership as Acting Administrator prior to his retirement in March and then to Mr. Dwight Ink who is filling in at this time until a new Administrator is confirmed.

The President has nominated an outstanding individual in Terry Golden. I personally believe he will provide quality and professional leadership necessary for an agency as large as the GSA. I have urged the Governmental Affairs Committee to act expeditiously on his confirmation so we can get out of the current situation.

Mr. Fontaine, I want you to know we welcome you and appreciate the fine job you do. You have a number of your colleagues at the table with you and I will just let you proceed in any manner you care.

Senator MATTINGLY. Before you begin, I would just like to say that I will probably not be able to stay throughout the entire hearing. I do have some questions that I would like to respond to in writing.

Mr. FONTAINE. We will be glad to do so.

Senator ABDNOR. That will be made part of the record.

OPENING STATEMENT

Mr. FONTAINE. Thank you, Mr. Chairman.

I would like to read a brief statement, introduce my colleagues, and then we can get right into the questions.

Senator ABDNOR. All right.

Mr. FONTAINE. I am pleased to appear today to summarize the 1986 budget for the GSA. I think this will prove helpful as you consider specific requests for each of our missions in greater detail.

In total, GSA's 1986 program will involve obligations of approximately $6.7 billion. Over 60 percent of this, however, will be financed by income from our customers, either as direct reimbursement for services or as payment for goods and services procured through the agency's revolving funds. The real property activities under the Federal buildings fund, financed by standard level user charges or SLUC, account for much of the rest. Less than 6 percent of the programs will require funding by new appropriations.

I might note for the record that these figures and others I will be discussing exclude programs for the former National Archives and Records Service. On April 1 of this year, it became an independent agency, the National Archives and Records Administration, and you have already heard their 1986 budget request.

Our 1986 request for new direct appropriations is $379.6 million, $14.7 million below the comparable 1985 program. While a very modest increase is assumed for inflationary cost growth and a few select program initiatives, it is more than offset by proposed reductions. These include a $1.8 million savings anticipated from contracting out certain of our supply functions, a directed 10-percent reduction in administrative costs, and the 5-percent reduction in employee salary rates proposed by the administration.

Achieving over $15 million in savings associated with the 10-percent administrative cost reduction goal will present a considerable challenge, particularly under our General Management and Administration Program. We are currently investigating a number of alternatives, among them organizational restructuring, although no final decisions have yet been reached.

We are also requesting enactment of $2.4 billion in new obligational authority for the Federal buildings fund in 1986. This limitation would be $44 million below projected resource availability based on holding SLUC rates to the same level in effect for 1985.

Requested 1986 authority, a net $139.7 million over 1985 levels, reflects substantial expansion of capital investment programs. An additional $233.3 million is proposed for new construction, for repairs and alterations, and related design and construction services. This is required for specialized space needs that cannot be met through leasing, and to contribute to our goal of improving the ratio of Government-owned to leased space. Under real property management and operating programs, we also need $51 million for rental rate increases in commercial space and other inflationary cost growth. These and other selected increases are partially offset by reductions in the leased space inventory, delegation of building operations to selected agencies, contracting out, productivity improvements, and other program decreases.

I think it would be appropriate to also mention that the 1986 request currently does not make provision for any new obligational authority under the national defense stockpile transaction fund. The administration is currently reviewing requirements for procurement of commodities for the stockpile, and we understand that appropriate adjustments to the budget will be made when final decisions are reached. Mr. Chairman, this concludes my brief overview of the 1986 GSA budget.

Now, Mr. Chairman, I would like to introduce my colleagues. This is Chuck Gillum, Acting Inspector General; Don Gray, Assistant Administrator of Federal Supply and Services; Bill Sullivan, Commissioner of the Public Buildings Service; Bill Early, Director of Budget; Frank Carr, Assistant Administrator for the Office of Information Resources Management; and Earl Jones, Acting Commissioner of the Federal Property Resources Service.

We would be happy to answer any questions you have.

Senator ABDNOR. Gentlemen, we welcome you all to the committee. We know you will do a very able job of filling in for the new Administrator.

Why do you not go ahead, Senator Mattingly, since you have to leave?

CONTRACTING OUT

Senator MATTINGLY. All right. Let me ask one question. As you know, there has been a great deal of discussion in the past about contracting out provisions and certain prohibitions on such activities. Can you explain what the GSA position is concerning contracting out services?

Mr. FONTAINE. Senator Mattingly, we are actively pursuing contracting out in many areas, particularly where we feel the Government would benefit economically. It is cost beneficial and in many cases, we find the Government comes out the winner.

In the Public Buildings Service, which is our biggest area, I will let Bill Sullivan talk in more detail. Current legislation prohibits certain functions from being contracted out, such as custodians, guards, and elevator operators.

Senator MATTINGLY. You said in your written statement that the 1986 request for new direct appropriations was $379.6 million. You also stated that there was a request for a modest increase in a few select program initiatives.

Could you briefly outline what these program initiatives are?

Mr. FONTAINE. I will defer to my Budget Director. He is the expert on numbers. We can give you a detailed list by account.

Senator MATTINGLY. Why do you not just do that for the record?

Mr. FONTAINE. Thank you, sir. I will submit a detailed list of increases by account.

[The information follows:]

GENERAL SERVICES ADMINISTRATION
Budget Authority
FY 1985 versus FY 1986
($000)

	FY 1985 Continuing Resolution	FY 1986 Estimate	Changes	Explanation of Difference
Federal Buildings Fund	348	-	-348	Appropriation transferred to State of Arizona for work related to border station.
Operating Expenses, PP	162,900	164,257	+1,357	+600,000 for accelerated Vehicle Disposal, +$2,621,000 for ADP initiatives; +$420,000 for SLUC increases; +$668,000 for inflation and common distributables; -$1,822,000 for base reductions and A-76 savings; -$353,000 for 5% pay cut; -$254,000 for administrative savings and -$523,000 for GS 11-15 grade reductions.
Operating Expenses, OIRM	33,422	30,630	-2,792	-$510,000 equipment update and productivity increase; -$1,620,000 for one-time 1985 projects; -$755,000 for reduced support of ADP Fund FDPC's; -$187,000 for NARS transfer; - $152,000 GS 11-15 grade reductions; -$93,000 for 5% pay cut; -$10,000 for administrative savings; +$27,000 for SLUC increase; and +$508,000 for inflation.
Operating Expenses, FPRS	38,921	40,748	+1,827	+643,000 for goods & services; +1,273,000 for space and handling costs; +$100,000 for protection and maintenance; -$60,000 for 5% pay cut; -$53,000 for GS 11-15 grade reductions; and -$76,000 for administrative savings
Stockpile Transaction Fund	(185,000)	(-)	(-185,000)	The FY 1986 program level has not been determined by the administration at this time.
Salaries and Expenses, GMA	136,633	123,410	-13,223	+$297,000 for ADP bid protest; +$2,012,000 for Automated Acquisition System; +$1,186,000 for price escalations for non-personnel related costs; +$2,194,000 for GSF NEAR conversion; +$202,000 for FAR printing; +$250,000 for contract maintenance; -$1,643,000 for NARA independence; -$17,064,000 for administrative savings; -$188,000 for 5% pay cut; and -$469,000 for GS 11-15 grade reductions.
Inspector General	21,261	19,305	-1,956	-$1,594,000 for administrative reductions; -$35,000 for Deficit Reduction Act; -$183,000 for GS 11-15 grade reductions; and -$144,000 for transfer for NARA support.
Former Presidents	1,151	1,208	+57	+$9,000 for pensions; and +$48,000 for communications utilities, printing, and miscellaneous expenses.
Presidential Transition	(3,000)	-	(-3,000)	-$3,000,000 result of incumbent being reelected--funds to be used to absorb pay act costs.
TOTAL	394,636	379,558	-15,078	

OPPORTUNITY PURCHASES

Senator MATTINGLY. Thank you, Mr. Chairman.

Senator ABDNOR. Yes; we have been joined by Senator DeConcini, who always makes a great contribution to this committee. We had opening statements but if you care to make any comments, you may.

Senator DECONCINI. I have no opening statement, Mr. Chairman. I will have some questions in a few minutes.

Senator ABDNOR. All right. Let us follow up on construction. Could you briefly outline the progress that GSA has made in the Opportunity Purchase Program? I see you have no funding requested in fiscal year 1986. Is that because you have some funding available?

Mr. SULLIVAN. Thank you, Mr. Chairman. We had, at the beginning of this fiscal year, approximately $135 million in the program. Currently, we have $108 million left. We have purchased three buildings thus far, one in Dallas, TX, one in Washington, DC, and one in Austin, TX.

We do not believe we need any additional funding in fiscal year 1986 because we have, as I said, $108 million left. We think that will be sufficient through fiscal year 1986. However, we may be coming back to you in subsequent budget years for additional money for the Opportunity Purchase Program.

Mr. FONTAINE. There is carryover from prior years. It is not annual money.

Senator ABDNOR. Well, I have been impressed by the program and the purpose behind it. We are not buying buildings, though, just because they are good buys. I mean, you are buying them where you really need them.

Mr. FONTAINE. Where we have high lease costs or the purchase is otherwise beneficial.

Senator ABDNOR. Well, I often wonder. How are we doing on the construction program? Everything is onboard and ready to go, those have all been properly authorized by both the House and the Senate? I mean, sometimes you get an inclusion into the budget that is not always to your preference. I do not want to put you on the spot by asking about it.

Mr. FONTAINE. There is a prospectus before the committee for every project. I can't say whether the authorizing committees are going to hear them all and act on them by the time you mark.

Senator ABDNOR. I really hope we can tie this down someday so we get the buildings that we need.

Mr. FONTAINE. It would be nice.

Mr. EARLY. There are no projects in the budget request for which the prospectuses are not either pending or already approved.

LONG BEACH FEDERAL BUILDING

Senator ABDNOR. Good. Where are we on the Long Beach project?

Mr. FONTAINE. Mr. Chairman, as you are aware, we received partial funding for that project last year. Our feeling is that it is not a high-

priority building for GSA. It is proposed as part of the fiscal year 1985 supplemental request that part of these funds be used for pay raise, because we cannot construct half a building.

We will do nothing until we see what the Congress does insofar as action on the 1985 supplemental request. If the rest of the money is appropriated, then we will proceed with construction of the building.

KENNEDY LIBRARY

Senator ABDNOR. We are talking about those projects. I recall I was quite involved in them. Where are we on the Kennedy Library?

Mr. FONTAINE. That is part of the National Archives and Records Administration

Senator ABDNOR. Yes; I am well aware.

Mr. FONTAINE. I believe they are in the process of letting a contract for design of the project.

Mr. EARLY. OMB has reported to you as a deferral for this year the bulk of the money in question. That will not delay the project at all as the National Archives and Records Administration is studying the scope of the project, the cost of the project and what is required.

Senator ABDNOR. Senator DeConcini.

MESA, AZ, OFFICE COMPLEX

Senator DECONCINI. Yes, Mr. Chairman.

Mr. Fontaine, I have somewhat of a parochial interest in Mesa, AZ, where some of your people have been very helpful. As you know, during the past year I have been working closely with the city of Mesa, AZ, to pave the way for a new Federal Postal Service Office Complex. This new facility, if approved, would service not only Mesa but the entire east valley, which is one of the most rapidly growing areas in all of Arizona.

Your staff, especially Mr. Al Iudicello and Ms. Molly Brant of the San Francisco office, have been most helpful. I wanted to tell you that personally. I have been meaning to call you, but since I knew you were coming up here today, I wanted to tell you they have been most helpful. They have not given away anything but they helped us. [Laughter.]

I do not want you to interpret that they have said yes by any means, but they have certainly provided us with ideas in assisting the city of Mesa in their study of this project.

Can you give us a status report on this?

Mr. SULLIVAN. Yes, Senator; our requirements for that proposed facility are approximately 20,000 square feet. As you know, we are working with the Postal Service. I believe that on May 22 they are going to be coming in with some indication as to just exactly what their plans are.

Our San Francisco office has been contacting other agencies to see what their requirements would be in the Maricopa County area. We are also continuing to work with the Postal Service, and we should have some indication from them of their plans in the near future. We will provide you something for the record on this.

[The information follows:]

STATUS OF PUBLIC BUILDING SERVICE PLANS FOR THE COMMUNITY OF MESA, AZ

Our current requirements in the Mesa area total approximately 20,000 square feet.

In addition, we are preparing a study of the Federal space situation in the entire Maricopa County area of Arizona to determine future space requirements. This study includes the community of Mesa. Over 50 letters have been sent to Federal departments and agencies, the judiciary and Members of Congress requesting projected space requirements for the next 5 and 10 years. This study is scheduled for completion in late June.

The U.S. Postal Service is evaluating their operational requirements for Mesa and their study will be complete in late May.

Assuming an economically feasible joint venture agreement can be reached, our plan is to piggyback on the firm development plans arrived at by the Postal Service for meeting their long term needs.

MESA, AZ, PROJECT

Senator DECONCINI. If that indication is positive and if they are, indeed, enthusiastic—I understand they are sending a team of west coast officials to Mesa in the next couple of weeks—assuming the Postal Service continues to embrace the idea, how much effect will that have on GSA and your final decision?

Mr. SULLIVAN. Of course, we will have to look at our requirements, which I indicated are around 20,000 square feet, and then determine what the most cost-effective solution would be. We believe that with favorable lease terms from the Postal Service, we will be able to cooperate with them, but again, we will have to look at what the Postal Service actually comes up with, that is,what lease costs they are going to be asking. So we cannot commit ourselves at this point.

Senator DECONCINI. Does the GSA have the statutory authority to do a multipurpose office complex such as this? This is not just a Government complex. There would be Federal space, commercial space, and Postal Service facilities under one roof.

Do you think we would have to amend the GSA statutory authority to allow GSA to participate in such a project or have you done one before?

Mr. SULLIVAN. I do not believe so. We have participated in that sort of project in the past. We would be leasing from the Postal Service, so there would be no amendment necessary. I think we have existing authority, although I would defer to our general counsel on that.

Senator DECONCINI. What about if there was a decision, which Postal Service is still working on, to sell their antiquated post office building they are in—no, it is a Federal building. What if there was a decision to sell the antiquated Federal building, can that be done and can the proceeds be used to facilitate a move as long as it is in your area? Do you have the right to sell Federal buildings?

Mr. SULLIVAN. Yes; we do. The Postal Service, however, is a separate entity. It would be their building to sell.

Senator DECONCINI. Excuse me. I am talking about the old Federal building, not the postal building. I am sorry.

Mr. SULLIVAN. We certainly have authority to sell a building. The sale would go through the established sales process. If we found that it was excess to our needs, we would go through the Federal Property Resources Service to accomplish the sale.

Mr. EARLY. Senator, I think the point that you are trying to make is an accurate one. Should the Postal Service sell their facility, they retain the proceeds for investing in other types of postal facilities.

Should we sell our facility because it becomes surplus to Government needs, those funds do not go back to the Federal buildings fund for the purchase or construction of a new building.

Senator DECONCINI. No; so that goes back to the general fund then.

Mr. SULLIVAN. The proceeds go to the Interior Department's Land and Water Conservation Fund.

Mr. JONES. A disposal of Postal Service property would be made under the Postal Services Act. The proceeds would go back to the Postal Service.

Senator DECONCINI. If they sell a building.

Mr. JONES. That is right.

Senator DECONCINI. But what about selling a Federal building that is not the Postal Services' building?

Mr. JONES. Then the proceeds would go on to the Land and Water Conservation Fund.

Mr. FONTAINE. GSA would not retain them.

Senator DECONCINI. Thank you.

If we were to move ahead and provide funding authority for the project in Mesa in fiscal 1986, what route would you recommend that we take, if any—direct appropriation to purchase the site, allow the private interest to build the building, GSA lease the buildings, or have you given any thought to that?

Mr. SULLIVAN. We had not anticipated being involved in construction there. We would simply lease space from the Postal Service.

Senator DECONCINI. A lease proposition.

Mr. SULLIVAN. That is correct.

Mr. FONTAINE. We can look into it and get back to you before the subcommittee marks.

Senator DECONCINI. You might give us some options that you have, realizing that it is a little bit ahead of time, but I want to keep working on it. I do not know if you have had a chance to visit Phoenix recently or the east part of that valley, but it is one of the fastest growing areas in the United States, and they are really under a lot of strain.

Mr. FONTAINE. We will get back to you with some options on what we think our best strategy would be.

Senator DECONCINI. Thank you very much.

Thank you, Mr. Chairman.

Senator ABDNOR. I do not want to dampen the prospects of your building in any way. I just want to tell you that in Pierre, SD, they all wanted this type of a building, and now I have all of the other citizens all over my neck because they have property there and the Federal building is in competition with it.

But I know Phoenix and Mesa are much faster growing communities than Pierre, SD, is, as much as I am sorry to say. One building can flood a lot of space in a town like Pierre.

Senator DECONCINI. I will keep that in mind, Mr. Chairman.

EMPLOYEE SPACE REQUIREMENTS

Senator ABDNOR. Are Government agencies cooperating with the GSA to meet that 135 square foot per person requirement? And how long do you think it is going to take to complete this initiative?

Mr. SULLIVAN. Quite honestly, we have had mixed success. Some agencies have been more cooperative than others. We have had some success, however. There has been a decline from 164 square feet per person in 1983 to 159 square feet per person at the present time.

Senator ABDNOR. Would you bring the microphone closer?

Mr. SULLIVAN. As I said, we have had somewhat mixed results. Several agencies have been very successful in reducing space: GSA, Treasury, DOD, Labor, and EPA are some of the more successful agencies.

We have reduced our space in the Federal Government from 164 square feet per person to 159 square feet. We have a new regulation which should be released for comments in the next few weeks that would request agencies' plans to get down to the 135 square foot level.

We are hopeful that within the next 5 years we can accomplish that reduction.

Senator ABDNOR. Where they are cooperating and where you have it in effect, is it working out quite well? Do you have any problems?

Mr. SULLIVAN. I think it has worked; we have reduced from an average of 164 to 159 square feet per person. Certain agencies have been helpful and certainly we are working closely with them. In all expansion space and for any other new space, we are adhering very closely to the 135 square foot goal. It is working, and I think we are going to have more success in the future.

Senator ABDNOR. May I ask you without embarrassing you who are some of those you are having difficulty with?

Mr. SULLIVAN. I would prefer to state who the real achievers are.

Senator ABDNOR. I can take those names and everyone else I can assume is not. Why do we not have a list of those? I think we have the right as the committee to ask you that.

Mr. SULLIVAN. Certainly. We will supply that for the record. We will provide you with a list of each agency's square footage utilization rate.

Senator ABDNOR. Everybody has been contacted?

Mr. SULLIVAN. Yes; they have. We will provide that list.

[The information follows:]

OFFICE UTILIZATION RATES [U.R.'S] OF DEPARTMENTS AND AGENCIES OCCUPYING MORE THAN 200,000 SQUARE FEET OF GSA-CONTROLLED OFFICE SPACE AS OF MARCH 4, 1985

Agency/Bureau		U.R.
Congress		248
House of Representatives	242	
Senate	260	
General Accounting Office		166
Judiciary		431
Administrative Office of U.S. Courts	191	
U.S. District Courts	442	
Referees in bankruptcy	383	
U.S. Court of Appeals	544	
Executive Office		203
Office of Management and Budget	230	
Peace Corps	174	
White House Office	183	
Agriculture		152
Agricultural Stabilization and Conservation Service	156	
Farmers Home Administration	144	
Forest Service	144	
Food and Nutrition Service	142	
Animal and Plant Health Inspection Service	161	
Soil Conservation Service	158	
Economic Research Service	146	
Agricultural Stabilization (County)	173	
Commerce		171
Bureau of the Census	155	
Patent and Trade Office	180	
National Oceanic and Atmospheric Administration	171	
Interior		164
Office of Surface Mining	179	
Geological Survey	178	
Bureau of Indian Affairs	146	
Bureau of Minerals Management Service	140	
Bureau of Land Management	160	
Bureau of Mines	169	
National Park Service	154	
Bureau of Reclamation	165	
Fish and Wildlife Service	159	
Justice		166
Federal Bureau of Investigation	139	
Immigration and Naturalization Service	152	
U.S. Marshals Service	193	
Drug Enforcement Administration	151	
U.S. attorneys'	226	
Labor		172
Mine Safety Health Administration	171	
Labor-Management Services Administration	212	
Occupational Safety and Health Administration	170	
Bureau of Labor Statistics	155	
Employment Training Administration	148	
Employment Standards Administration	172	
Navy		133
Postal Service		98
State		149
Consular Affairs	154	
Treasury		134
Financial Management Service	188	
U.S. Customs Service	161	
Internal Revenue Service	127	
Bureau of Alcohol, Tobacco and Firearms	167	
U.S. Secret Service	171	

OFFICE UTILIZATION RATES [U.R.'S] OF DEPARTMENTS AND AGENCIES OCCUPYING MORE THAN 200,000 SQUARE FEET OF GSA-CONTROLLED OFFICE SPACE AS OF MARCH 4, 1985—Continued

Agency/Bureau		U.R.
Army		151
Corps of Engineers	147	
Adjutant General Corps	131	
Materiel Development and Readiness Command	121	
Armed Forces Recruiting	174	
Military Enlistment Processing Command	249	
Office of Personnel Management		208
Federal Communications Commission		200
Federal Trade Commission		197
Interstate Commerce Commission		168
Nuclear Regulatory Commission		197
Veterans' Administration		170
Equal Employment Opportunity Commission		193
General Services Administration (without joint use or outlease space)		142
Office of the Administrator	162	
Office of Acquisition Policy	135	
Office of Inspector General	139	
National Archives and Records Service	162	
Public Buildings Service	127	
Office of Federal Supply and Services	134	
Regional Public Buildings Service	133	
Regional NARS Records Depositing Operations	143	
Public Buildings Service Field Office	139	
National Science Foundation		177
Securities and Exchange Commission		168
Executive Office of the President		157
Air Force		118
Federal Emergency Management Agency		127
Railroad Retirement Board		183
National Labor Relations Board		219
U.S. Information Agency		140
Environmental Protection Agency		138
Transportation		167
Coast Guard	140	
Federal Aviation Administration	150	
Federal Highway Administration	178	
Agency for International Development		214
Small Business Administration		164
Health and Human Services		159
Health Services Administration	159	
Social Security Administration	155	
Health Care Financing Administration	160	
Food and Drug Administration	176	
National Institute of Health	160	
National Aeronautics and Space Administration		201
Housing and Urban Development		160
Energy		175
Education		186
Defense		130
National Security Agency	81	
Defense Logistics Agency	122	
Defense Investigative Service	127	
Defense Contract Audit Agency	149	
Nationwide (without GSA joint use or outlease space)	159	

FEDERAL LEASED SPACE

Senator ABDNOR. As you are aware, this subcommittee is concerned about what we call the Washington Monument mentality that prevails in Washington and we are committed to getting agencies or divisions of those agencies which are not vital to the operations of the Government out of high-priced leased space.

Now, for the record, could you provide a list of agencies housed in leased space in the Washington metropolitan area, the amount of space they require and the cost per square foot and total cost? That would be helpful to us.

Mr. FONTAINE. We will provide that information.

[The information follows:]

LEASED SPACE IN WASHINGTON METROPOLITAN AREA BY MAJOR AGENCY

Agency	Leased space (Square foot)	Rental fiscal year 1985	Personnel	Dollar/ square foot	Dollar/ person
Agriculture	761,000	9,054,000	3,378	11.90	2,680.28
AID	343,000	5,497,000	2,207	16.03	2,490.71
Commerce Department	2,057,000	25,632,000	9,636	12.46	2,660.02
Defense Department	5,740,000	48,233,000	37,051	8.40	1,301.80
Education Department	181,000	1,662,000	787	9.18	2,111.82
Energy Department	421,000	2,981,000	1,876	7.08	1,589.02
EPA	1,013,000	7,888,000	5,966	7.79	1,322.16
GSA	782,000	5,411,000	2,290	6.92	2,362.88
HHS Department	2,794,000	18,530,000	13,453	6.63	1,377.39
HUD	30,000	382,000	160	12.73	2,387.50
Interior Department	1,609,000	13,440,000	6,122	8.35	2,195.36
Judiciary	163,000	2,360,000	482	14.48	4,896.27
Justice Department	1,844,000	21,611,000	7,872	11.72	2,744.60
Labor Department	618,000	5,673,000	3,288	9.18	1,725.36
NASA	23,000	354,000	143	15.39	2,475.52
OPM	138,000	2,150,000	490	15.58	4,387.76
State Department	659,000	6,146,000	3,932	9.33	1,563.07
Transportation Department	2,432,000	12,151,000	7,735	5.00	1,570.91
Treasury	1,218,000	13,568,000	5,040	11.14	2,692.06
Veterans' Administration	327,000	2,247,000	1,075	6.87	2,090.23
Other	5,709,000	71,185,000	22,053	12.59	3,259.19

NOTE.—Data provided above shows the amount of assigned leased space, the number of employees housed, the estimated rental to be paid to lessors (excluding services and utilities paid by the General Services Administration), the average cost per square foot leased, and the average cost per employee housed.

VEHICLE PROCUREMENTS

Senator ABDNOR. The Deficit Reduction Act reduces the vehicle procurement by $30.6 million in fiscal year 1985. What impact did this have on the GSA procurement activity?

Mr. GRAY. Mr. Chairman, the $30.6 million reduction has several impacting factors that had not been anticipated. There are about 5,000 overage/over-mileage vehicles that will not be replaced within the GSA interagency fleet. The impact of deferring replacement of these vehicles will be $9.8 million in fiscal year 1985. For every year the deferral continues for replacement of 5,000 vehicles, it is estimated that additional costs and lost savings will accrue by $2.8 million per year.

Prior to the Deficit Reduction Act we were proceeding with a solicitation with the auto industry for our new procurement. When the act took place, we had to withdraw that particular solicitation and replace it with a solicitation of smaller quantity. Through this process we were able to develop a cost comparison of a big buy. The smaller volume cost an additional $7 million over the larger volume that we were going to be buying.

So there have been several things that have happened to us with regard to vehicle procurement reductions in fiscal year 1985. In connection with this, the statutory price limitations are in need of some adjustments. As an example, the statutory price limitations for sedans is at $6,000 and we really need to go to $6,600; station wagons are currently at $6,400 and we need to go to $7,600; special heavy-duty vehicles are currently at $3,600 and we seek an increase to $4,000. For the police-type vehicles, no change is required.

STOCKPILE FUNDING

Senator ABDNOR. No funding was requested for the stockpile. Can the subcommittee expect to see any stockpile request?

Mr. JONES. Mr. Chairman, the administration is presently studying stockpile goals and the program level. When that study is completed, there will be a modified request for the 1986 program level.

Senator DECONCINI. When will that study be completed?

Mr. JONES. The study is being performed by the National Security Council, so I really cannot tell you when it will be completed. We hope it is soon.

Senator DECONCINI. Are you participating in the study at all?

Mr. JONES. We are participating on a limited basis. We are not one of the principals.

Senator DECONCINI. Do you know what the stockpile of copper is now?

Mr. JONES. Yes, sir, I do.

Senator DECONCINI. What is that? Can you disclose that to me, please? If it is classified, I will get it later.

Mr. JONES. The stockpile inventory of copper is 29,048 short tons.

Senator DECONCINI. Is it a big job to supply me with the information on basic metals, including copper, and the stockpile to date?

Mr. JONES. No, sir; we can do that.

Senator DECONCINI. Can you do that for me?

Mr. JONES. Yes, sir.

Senator DECONCINI. Thank you, Mr. Chairman.

[The information follows:]

LARGEST STOCKPILE HOLDINGS OF BASIC METALS

Tin, silver, cobalt, titanium, zinc, lead, and copper.

TRANSACTION FUND

Senator ABDNOR. The stockpile fund is in a quandary since the passage of the DOD Authorization Act that authorized the fund to receive 30 percent of the naval petroleum and oil shale reserve. Could you briefly describe where we are and what we have to do to get things back on track?

Mr. JONES. Mr. Chairman, I think, as is indicated in the budget, the administration proposes to seek legislation to rescind that authority. There have been some funds from the naval petroleum reserve placed in the national defense stockpile transaction fund in accordance with the authorizing legislation.

Senator ABDNOR. We will see what happens to that.

DESIGN AND CONSTRUCTION

For the record we would like to ask you to provide us with a listing of the projects which will be looked at in the design and construction account. Would you do that?

Mr. FONTAINE. We would be glad to.

[The information follows:]

DESIGN AND CONSTRUCTION SERVICES

NEW OBLIGATIONAL AUTHORITY BY PROJECT

	Design	Management/ inspection	Total
Fiscal year 1986 new construction:			
Los Angeles, CA, FB/PF	$9,423,000	$3,425,000	$12,848,000
Eastport, ID, BS	181,000	145,000	326,000
Overland, MO, NPRC Ext	2,949,000	2,416,000	5,365,000
Newark, NJ, FB	0	1,636,000	1,636,000
Seattle, WA, lab	719,000	559,000	1,278,000
Small projects	48,000	48,000	96,000
New construction	13,320,000	8,229,000	21,549,000
R&A projects scheduled for construction in fiscal year 1986:			
Hawthorne, CA, Federal Bldg	78,000	167,000	245,000
Los Angeles, CA, courthouse	0	180,000	180,000
Denver, CO, Fed. bldg/custhse	0	470,000	470,000
Washington, DC, GAO bldg	0	891,000	891,000
Washington, DC, ICC customs	0	158,000	158,000
Washington, DC, Pension bldg	0	918,000	918,000
Washington, DC, steam dist. plant	0	759,000	759,000
Chicago, IL, Kluczynski FB	0	291,000	291,000
Peoria, IL, FB/CT	0	73,000	73,000
Fort Wayne, IN, PO/CT	0	290,000	290,000
Louisville, KY, PO/CT	117,000	303,000	420,000
Wichita, KS, CT	0	339,000	339,000
Lafayette, LA, FB/CT	30,000	145,000	175,000
Detroit, MI, McNamara FB	0	418,000	418,000
Kansas City, MO, Federal bldg	0	361,000	361,000
Manchester, NH, PO/CT	0	139,000	139,000
Utica, NY, FB/CT	42,000	124,000	166,000
Cleveland, OH, Celebrezze FB	0	358,000	358,000
Oklahoma City, OK, PO/CT	0	169,000	169,000
Scranton, PA, PO/CT	0	270,000	270,000
Hato Rey, PR, FB/CT	0	118,000	118,000

DESIGN AND CONSTRUCTION SERVICES—Continued

NEW OBLIGATIONAL AUTHORITY BY PROJECT—Continued

	Design	Management/ inspection	Total
R&A projects scheduled for construction in fiscal year 1986—Continued			
Dallas, TX, Cabell FB/CT	0	$277,000	$277,000
Dallas, TX, terminal annex	$506,000	322,000	828,000
Fort Worth, TX, warehouse 1	0	139,000	139,000
San Antonio, TX, PO/CT	0	334,000	334,000
Richmond, VA, FB	115,000	79,000	194,000
R&A construction	888,000	8,092,000	8,980,000
R&A projects scheduled for design in fiscal year 1986:			
Juneau, AK, PO/CT	371,000		371,000
Birmingham, AL, FB/CT	429,000		429,000
Phoenix, AZ, FB/CT	88,000		88,000
Los Angeles, CA, FB	1,064,000		1,064,000
Pasadena, CA, FB/CT	433,000		433,000
San Diego, CA, FB/CT	88,000		88,000
San Francisco, CA, FB/CT	3,652,000		3,652,000
Denver, CO, FB/CT	1,318,000		1,318,000
Denver, CO, DFC	352,000		352,000
Bridgeport, CT, CT/FOB	208,000		208,000
Washington, DC, FB-new post off	187,000		187,000
Washington, DC, State Dept	754,000		754,000
Jacksonville, FL, FB	549,000		549,000
Miami, FL, FB	676,000		676,000
Chicago, IL, customhouse	99,000		99,000
Chicago, IL, Railrd Retire Bd	442,000		442,000
East St. Louis, IL, PO/CT	359,000		359,000
Boston, MA, JFK Federal Bldg	2,154,000		2,154,000
St. Louis, MO, Mart Fed. Bldg	3,944,000		3,944,000
Raleigh, NC, FB/CT	434,000		434,000
Newark, NJ, Rodino Fed. Bldg	1,371,000		1,371,000
Trenton, NJ, post off/court	357,000		357,000
Brooklyn, NY, Cellar Fed. Bldg	1,054,000		1,054,000
Brooklyn, NY, Fed. Bldg. 2	766,000		766,000
Buffalo, NY, Federal Bldg	1,149,000		1,149,000
New York, NY, 201 Varick St. FB	1,161,000		1,161,000
New York, NY, 26 Fed. Plaza	4,719,000		4,719,000
New York, NY, Foley Sq Courthse	797,000		797,000
Philadelphia, PA, FB/PO	893,000		893,000
Charleston, SC, Rivers Fed. Bldg	215,000		215,000
Dallas, TX, Federal Bldg	176,000		176,000
Arlington, VA, FB-2	635,000		635,000
Arlington, VA, Pentagon	1,743,000		1,743,000
Spokane, WA, FB/PO	496,000		496,000
Milwaukee, WI, FB/CT	308,000		308,000
R&A design	33,441,000		33,441,000
Costs for prior years and minor projects			59,124,000
Total design and construction services			123,094,000

DELEGATION OF BUILDINGS MANAGEMENT

Senator ABDNOR. In fiscal year 1986, it is proposed that selected agencies will be delegated responsibility for management of their facilities. Would you describe which agencies will be involved and how it will work and what is hoped to be accomplished? Is this a test which will be expanded in the future?

Mr. SULLIVAN. We have had several agencies, nine thus far, to which we have delegated operational responsibilities. They are all in the Washington, DC, area.

We intend to expand that program nationwide. By the conclusion of fiscal year 1986, we hope to have the majority of single-tenant buildings delegated to the resident agencies. Essentially, we are looking closely at those agencies that have the capability to handle such delegations.

They must have the accounting, budgeting, buildings management and procurement experience to handle buildings delegations. We are looking at those kinds of qualifications of the agencies. The administration believes that there would be increased agency satisfaction in being able to control their own buildings.

They should be able to be more responsive to the management of that agency. It is a program that we are quite enthusiastic about, but it is one where we want to delegate only to agencies that are qualified. We also want to carefully monitor the funds that the agencies are expending to run the buildings.

Senator ABDNOR. Up to date, it looks very promising.

Mr. SULLIVAN. It has been thus far, and agency satisfaction in the program has been quite high. It is something the agencies seem to be enthusiastic about and we are also.

Senator ABDNOR. Again for the record, could you provide us a list of the 16 purchase contract projects which the budget proposes to take title to during fiscal year 1986 and what the outlay savings would amount to?

Mr. SULLIVAN. Certainly.

[The information follows:]

PROJECTED TAX SAVINGS FOR PURCHASE CONTRACT PROJECTS FINANCED THROUGH THE FEDERAL FINANCING BANK FISCAL YEAR 1986 THROUGH PAYOFF

FS	Reg	City and State	Date of P/contract	Date of const. compl	Payoff date	Gross sq. ft.	Occ. sq. ft.	Estimated tax liability/savings		
								1986	Out-years through payoff date	Total
L	1	New Haven, CT	11-15-74	7-15-78	2004	186,790	116,146	$320,000	$6,797,000	$7,117,000
L	1	Pittsfield, MA	11-15-74	4-28-78	2004	30,518	18,646	42,000	892,000	934,000
M	3	Metro-West, MD	6-26-75	2-1-80	2003	952,410	952,410	2,283,000	45,409,000	47,692,000
M	3	Norfolk, VA	6-26-75	2-1-79	2003	250,273	185,715	124,000	2,466,000	2,590,000
M	3	Woodlawn, MD	6-26-75	6-1-80	2003	448,444	448,444	900,000	17,901,000	18,801,000
L	4	Columbia, SC	11-15-74	8-10-75	2004	274,159	215,974	324,000	6,882,000	7,206,000
L	4	Ft. Lauderdale, FL	11-15-74	2-26-79	2004	253,649	204,045	450,000	9,558,000	10,008,000
L	4	Jackson, MS	11-15-74	6-27-79	2004	464,074	290,378	428,000	9,091,000	9,519,000
M	4	Atlanta, GA	6-26-75	3-29-80	2003	1,215,376	809,592	1,685,000	33,515,000	35,200,000
K	5	Carbondale, IL	6-27-75	2-8-80	2004	37,497	15,930	0	3,929,000	3,929,000
L	5	Saginaw, MI	11-15-74	6-15-77	2004	91,660	32,063	105,000	2,230,000	2,335,000
K	6	Topeka, KS	6-27-75	3-14-77	2004	320,670	233,897	287,000	6,096,000	6,383,000
L	7	Marfa, TX	11-15-74	11-23-77	2004	26,952	22,983	0	0	0
L	8	Huron, SD	11-15-74	9-1-77	2004	94,375	69,151	98,000	2,082,000	2,180,000
K	10	Anchorage, AK	6-27-75	2-11-81	2004	631,270	488,883	740,000	15,718,000	16,458,000
K	10	Fairbanks, AK	6-27-75	11-18-77	2004	197,330	157,805	160,000	3,398,000	3,558,000
	16	Projects Total				5,475,447	4,262,062	7,946,000	165,963,000	173,909,000

REMAINING PROJECTS

• Senator ABDNOR. How many other purchase contract projects are there? Do you have many more?

Mr. EARLY. There are 57 other purchase contract facilities.

Senator ABDNOR. Why do you not give us a listing of those, too, if you do not mind.

[The information follows:]

LISTING OF REMAINING 57 PURCHASE CONTRACT PROJECTS

Arizona: Tucson, FB.
Arkansas: Batesville, PO CT FOB.
California: Richmond, SSA Western Program Center; San Diego, FB; Santa Ana, FB; Santa Rosa, FB; Van Nuys, FOB.
Delaware: Dover, FOB.
Florida: Orlando, CT FOB.
Georgia: Athens, FOB; Atlanta, CDC; Rome, PO CT.
Hawaii: Honolulu, Prince J.K. Kalanianaole FB CT.
Illinois: Chicago, SSA Midwestern Program Center; Chicago, GSA FARC; Mt. Vernon, Kenneth J. Gray FB.
Indiana: Indianapolis, FOB.
Iowa: Iowa City, PO FOB.
Idaho: Moscow, FB PO CT; Sandpoint, FB.
Kansas: Kansas City, PO CT.
Louisiana: New Orleans, Hale Boggs FB CT.
Maryland: Baltimore, Edward A. Garmatz FB CT.
Massachusetts: Fitchburg, Philip J. Philburn, FB; New Bedford, Hastings Keith FB.
Michigan: Ann Arbor, FOB; Detroit, Patrick V. McNamara FOB.
Mississippi: Hattiesburg, William M. Colmer, FB CT.
Nebraska: Lincoln, CT FOB and PF; Omaha, PO CT.
New Hampshire: Manchester, Norris Cotton Building.
New Mexico: Albuquerque, FOB; Las Cruces, CT FOB.
New York: Albany, L. W. O'Brien FB; New York, CU CT FOB Annex; Syracuse, CT FOB.
North Carolina: Winston-Salem, CT FOB.
Ohio: Akron, FB CT; Columbus, FOB, PF; Dayton, FB CT.
Oklahoma: Oklahoma City, Alfred P. Murrah FB.
Oregon: Eugene, FB CT; Portland FB.
Pennsylvania: Philadelphia, SSA Mid-Atlantic Program Center; Williamsport, CT FB.
Puerto Rico: San Juan, CT FOB.
South Carolina: Florence, J.K. McMillan FB CT.
South Dakota: Aberdeen, FOB; Rapid City, CT FOB.
Tennessee: Nashville, FB CT, garage/tunnel.
Texas: Fort Worth, FOB PF; Pearsall, PO FOB.
Vermont: Essex Junction, Winston Prouty FB PO.
Virginia: Roanoke, Richard H. Poff FB CT.
Virgin Islands: Charlotte Amalie, CT FOB.
Washington: Wenatchee, FB PO.
West Virginia: Huntington, FOB.

PROJECT SAVINGS

Mr. FONTAINE. I can tell you that the savings for the 16 projects is approximately $173.9 million for the remaining 19 years.

Senator ABDNOR. I may have one of my own in South Dakota.

Mr. FONTAINE. They are all around the country.

Senator ABDNOR. It happened before I got in, though.

FIRE PROTECTION

Let me talk for a second about fire protection which is important to the Government. Steps are being taken to upgrade the fire protection system throughout Government, and I am concerned, however, that as the Government phases in more automation that water systems may ill serve our needs.

I understand there are foam and even dry systems such as Halon 1211 or 1301 which would better serve our needs. Would you care to comment on that?

Mr. SULLIVAN. In general, Mr. Chairman, we believe that water is the most effective fire extinguishing agent. It absorbs heat better than any other agent. Halon is usually used in flammable liquid spill fires. It is toxic, and quite often the Halon systems go off prematurely when there is an activation of a smoke detector. Of course, with an incidence of false alarms, you are going to have these detectors go off.

We are, of course, exploring alternatives to the use of water particularly for areas with telephone equipment. Halon could well be one of those alternatives. I think that possibly Mr. Carr might want to comment on that.

Mr. CARR. We are jointly looking at it because it would create a problem, particularly where water is used, if we were to get a false alarm and the water came on. It could wipe out a telecommunications switch which would be a fairly serious problem in running the building.

Senator ABDNOR. You could probably put the fire out with water but the equipment——

Mr. CARR. It could put ADP and telecommunications equipment out of operation.

Senator ABDNOR. Yes; the computers and all that go with it. I do not know how much water they withstand.

Mr. SULLIVAN. It is something we are sensitive to and are looking at. In general, water is preferable to Halon, although maybe not for that particular use.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Gentlemen, I do not have any additional questions. We may have some for the record if you do not mind. We realize it has been somewhat difficult for you to come on here without an Administrator, but you have done an excellent job and you run a fine organization and we thank you very much for your coming.

Mr. FONTAINE. Thank you, Mr. Chairman.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Questions Submitted by Senator Mack Mattingly

Mr. Mattingly. Could you briefly outline what has happened in the surplus property sales program and what are the projections for Fiscal Year 1986?

Mr. Gray. The Property Management Sales Program produced the highest proceeds in its history during fiscal year 1984 as a result of exceptional and one-time generations of vehicles reported for sales action. Proceeds or revenues exceeded $70 million because of selling 300,000 line items of property, including more than 35,000 vehicles. Ninety percent or better of all property reported for sale by customer agencies was competitively sold to the general public in 60 days or less. Use of commercial auctioneering firms to sell Government vehicles is being tested to determine if such firms can both sell faster and produce higher revenues. Proceeds for fiscal year 1985 will exceed $50 million; proceeds for fiscal year 1986 are estimated to exceed $60 million.

SURPLUS REAL PROPERTY SALES PROGRAM

Mr. Mattingly. What about the Surplus Real Property Sales Program? What are the projections for fiscal year 1986?

Mr. Jones. The sales estimate for FY 1986 is $275,000,000. Sales of $124,000,000 will be from surplus real property in our current inventory and sales of $151,000,000 will be generated from property that we anticipate becoming available for sale in the future.

NATIONAL DEFENSE STOCKPILE TRANSACTION FUND

Mr. Mattingly. I notice the 1986 request does not make any provision for any new obligational authority under the National Defense Stockpile Transaction Fund. You mentioned in your statement that the administration is currently reviewing requirements for the procurement of commodities for the stockpile. Do you know when this review might be concluded and what effect it may have on your request?

Mr. Jones. At this time we do not know when this review, conducted by the National Security Council, will be concluded. Although we did participate in the review on a limited basis, we will not know the total impact on our budget request until it is completed.

BLAIR HOUSE

Mr. Mattingly. Money was appropriated in FY 1985 for renovation of the Blair House. Could you bring us up to date on what has been accomplished? What is the projected completion date? Are we on schedule?

Mr. Sullivan. The design of the project has been completed. Construction contractors have been preparing their bids which are scheduled for submission on May 17, 1985. The contract is planned for award in June 1985 with construction completion in March of 1987. The project is on schedule.

ART-IN-ARCHITECTURE PROGRAM

Mr. Mattingly. Through the years the Art-in-Architecture program has raised questions--both pro and con--as to its contribution. Could you briefly outline the history of this program and what its future may hold? Has GSA faced any legal problems with regard to efforts to dismantle certain contracted-for projects?

Mr. Sullivan. The Art-in-Architecture program was established in 1963 by a direct policy order from the Administrator. The Administrator initiated this program in response to a Presidentially-appointed task force called the President's Ad Hoc Committee on Federal Office Space. They issued a report dated June 1, 1962, entitled GUIDING PRINCIPLES FOR FEDERAL ARCHITECTURE, which recommends that, "Where appropriate, fine art should be incorporated in the designs (of Federal buildings) with emphasis on the work by living American artists."

The Administrator's policy order establishes an allowance for fine arts of one-half of one percent of the estimated construction cost of new buildings and of

buildings undergoing significant repair or alteration which would affect the architectural character of the buildings. The architect is responsible for developing a fine arts proposal as part of his total design concept, including the location, nature and character of the proposed fine arts.

From 1963 to 1966, GSA commissioned 45 works of art at a total cost of $1,176,765. Artists were nominated by the architect, recommendations were made by The Commission on Fine Arts in Washington, D.C., and selections were made by the Administrator. In 1966, the program was suspended due to inflationary increases in the construction industry and some controversy that existed over a large mural in the John F. Kennedy Federal Building in Boston.

Over the years, the scope and breadth of this program have been modified due to budgetary concerns as well as fluctuating support for, and interest in, this program at the highest levels of Government. The 1966 suspension was lifted in mid-1972 at the request of President Nixon who issued a memorandum in May 1971 to the heads of all agencies stating, "It is my urgent desire that the growing partnership between Government and the arts continue to be developed to the benefit of both, and more particularly to the benefit of the people of America." Subsequently, GSA announced that approximately one-half of one percent of the estimated construction costs for Federal buildings projects would be reserved for the fine arts. Since that time, GSA has worked with the National Endowment for the Arts to strengthen the program.

Essentially, artists are nominated for specific commissions by private citizens serving at the request of the National Endowment for the Arts on an ad hoc basis. The architect is involved in the nomination process. Approximately four years ago, GSA began to draw the community into the process. Current procedures require consultation with local communities and political representatives. This has proved to be successful in terms of gaining community support for the artists and their commissioned artworks without diminishing the quality, variety, and significance of the works of art. However, there still exists a need to codify community consultation into the regulations that govern the Art-in-Architecture program. We are now in the process of revising the program policy to do precisely that. To expound further on the current process, once we (GSA) have received the list of nominated artists, our Design Review Panel carefully looks at a broad cross-section of each artist's previous work, and based upon this review, makes a recommendation to the GSA Administrator as to which artist is the most appropriate for selection. The Administrator makes the final selection. Serving on the GSA Design Review Panel are officials from both GSA's Central Office and Regional Office.

This same GSA panel reviews the artist's design proposal, focusing on practical considerations as well as aesthetic ones. Once the artwork proposal is approved, the artist creates the full-scale work and is responsible for its installation.

There has been much said - both pro and con - as to the contribution of the Art-in-Architecture program. Most of the negative comments have been directed at one or another particular work of art. A number of initially controversial works, such as Claes Oldenburg's "Batcolumn" and Alexander Calder's "Flamingo" in Chicago, have become city landmarks. Perhaps the most visible measure of the program's contribution came in the form of a Presidential Award given this past January by President Reagan to the program. It was one of only 13 Presidential Design Awards for Excellence given and represented the accomplishments of the program during the last decade.

The program's future would appear to be strong. We are currently working with our regional offices to strengthen the role of the community throughout the process -- from selection to installation.

GSA has not faced any legal problems with regard to the dismantling of certain contracted-for projects due to the fact that as of this date, we have not dismantled, removed, or relocated any work of art selected via the Art-in-Architecture process and commissioned under the Art-in-Architecture program.

LEASED SPACE

Mr. Mattingly. What do we spend a year for leased space? How much of that expenditure is made in areas where there is available government owned space? Does GSA face problems in getting agencies to move into government space?

Mr. Sullivan. In fiscal year 1984, GSA spent $800.5 million. We project an expenditures of approximately $840 million this fiscal year.

It is GSA's policy not to lease space where there is vacant available space that is suitable in quantity and quality or can be made so to meet the Government's space requirements. In the District of Columbia, which has the largest expenditure for leased space of approximately $135 million annually, there is about 600 thousand feet of vacant government-owned space. About half of this is office space and the remainder is storage or special purpose space. The Government's vacancy rate in DC is less than 1 percent and compares favorably with the private commercial sector which averages about 8 percent. To the extent possible, where there is sufficient quantity to suit a new or expansion requirement, the government-owned space is utilized. GSA systematically screens the use of this space against known and verified space needs of agencies.

Agencies are generally receptive to backfilling vacant available government-owned space.

Currently our vacant government-owned office space totals 4.5 million square feet or 6%.

However, the majority of that space is committed for occupancy by Federal agencies.

Taking the committed space into consideration, the government-owned office vacancy rate for space available to Federal agencies is only 2.5%.

SPACE IN CALIFORNIA

Mr. Mattingly. The San Francisco area is as expensive as any for leased space. How much space does the Government own there? How much is leased? What does it cost? How does Oakland fit into the picture? Isn't downtown Oakland a better application of resources than downtown San Francisco? What is being done?

Mr. Sullivan. Of the 5.1 million square feet of space controlled by GSA in the Bay Area, 3.4 million square feet are located in the core cities of San Francisco and Oakland. Of that space, 1.8 million square feet is government-owned; 1.6 million square feet is leased. The ratio of government-owned to leased space is 52/48.

The cost of leasing space in the Bay area is about $34.5 million annually, an average rate or almost $18 per square foot. Within the next 3 fiscal years, over half of the current leases will expire; within 5 years, 85% will expire. By that time, annual rent will be approximately $52.5 million. Sixty-four percent of this leased space is located in the two core cities of San Francisco and Oakland.

The current rental market rate in San Francisco ranges from $24-$32 per square foot, the top of the range being in the financial district. In Oakland, the rate is about $24 per square foot.

Oakland historically has absorbed office spillover when San Francisco office vacancies are scarce. Its downtown area is experiencing office expansion and, as a geographic hub of the Bay area with good public transportation access, Oakland offers a metropolitan alternative to San Francisco.

GSA is exploring with the Office of Management and Budget the expansion of San Francisco as a designated regional city to include Oakland. Until then, the regional headquarters of socio-economic agencies remain in San Francisco. Most of them are currently collocated with their components and would not be interested in disaggregation.

GSA has been offered a construction site for a Federal Building in Oakland by the City of Oakland. We are evaluating that proposal, with other alternatives, in developing a long-term plan for housing Federal agencies in the Bay area.

Questions Submitted by Senator William Proxmire

Senator Proxmire. Your travel and transportation of persons budget increases by $1,572,000 or 14.8% over 1985 levels. Yet your fulltime staffing drops by about 630 FTE. Why are you asking for nearly a 15% boost in travel of persons when your staffing is dropping? How did this item escape the OMB knife in a year when we are working at freeze levels or lower?

Mr. Fontaine. The travel increase of $1,571,000 consists of $152,000 for the operating expenses appropriations and $1,419,000 for the revolving funds and reimbursable accounts. This increase is for partial restoration of the travel reductions imposed by the Deficit Reduction Act which are reflected in the 1985 column of the 1986 budget. These consist of $485,000 for the appropriations and $1,866,000 for revolving funds, for a total Deficit Act reduction of $2,351,000.

The travel amounts in the Congressionally approved FY 1985 budget were reduced from $12,975,000 to $10,624,000 under the Deficit Reduction Act. The FY 1986 request of $12,164,000 is $811,000 below the FY 1985 initially approved travel amounts.

The FY 1986 travel request is essential to the efficient performance of our basic mandated programs, entailing periodic travel by middle management employees and top level agency officials. The net decrease of 530 FTE's in 1986 is not directly related to the travel request since this reduction is principally due to contracting out of programs under OMB Circular A-76, heretofore performed in-house. An example is the decrease of 434 FTE's in the supply area of Operating Expenses, Personal Property account due to projected self-service store closures and depot closures and contracting out under A-76.

EQUIPMENT INCREASE

Senator Proxmire. Your equipment budget for fiscal 1986 increases by a whopping $55 million over 1985--an increase of 38% over the $144.6 million budget for last year. Perhaps this huge increase in equipment is an accumulation of small, new equipment purchases, but can you explain to us why we need to approve an increase of this magnitude for equipment at GSA next year?

Mr. Gray. The equipment increase of $55 million is associated with the procurement of vehicles in the Interagency Fleet Management System (IFMS) which meet the normal replacement criteria. While the level for FY 1986 represents our normal level for vehicle replacement, there were two factors which reduced the FY 1985 program, thereby creating the $55 million change. First, in FY 1984, we took advantage of an exceptional price offer by the manufacturer and accelerated our replacement program by $25 million for vehicles that would normally have been replaced in FY 1985. Therefore, the FY 1985 program was reduced by $25 million to compensate for the opportunity buy option we exercised in FY 1984. Secondly, the FY 1985 Deficit Reduction Act mandated lower expenditure levels for motor vehicles.

The amount prorated to GSA was $30 million. The combined effect of these two actions reduced the vehicle program in FY 1985 by $55 million. The FY 1986 level reflects the resumption of our normal program. It should also be noted that the IFMS is a revolving fund operation through which the vehicles are purchased and all costs are recovered in the rates we charge our customer agencies. The $55 million increase from FY 1985 to FY 1986 does not represent a request for any additional Budget Authority (appropriation).

OFFICE OF INSPECTOR GENERAL

Senator Proxmire. Your FY 1986 budget calls for cutting the Inspector General office to a funding level that is below your FY 1984 appropriation. Now, I will almost always stand up and cheer when an agency can cut its expenses back below prior year's funding. But if there is one office in GSA that probably needs to be beefed up, it's the Inspector General. Can you give us the reasons why this Office was hit so hard and what steps you will have to take to absorb the cuts? Will it involve fewer audits? Will it cause fewer reports to Congress or what will happen.

Mr. Gillum. Although I cannot specifically explain the rationale behind the decisions which resulted in the Office of Inspector General's budget being reduced, the specific categories of reduction between FY 1985 and FY 1986 are as follows:

Categories	Amount Reduced ($ in Thousands)
Deficit Reduction Act	35
5% Pay Decrease	64
SLUC Freeze	100
10% Administrative Reduction	1,900
NARS Separation	321
Total	$2,420

As we expressed last month at the House Appropriations Committee Hearings, based on current cost levels and staffing patterns, we are conservatively projecting full-time staffing for FY 1986 in the area of 381 to 385.

In a position paper, which we prepared when we were initially advised of the reduced target levels and which was presented to agency officials as well as OMB officials, we projected that based on the reduced funding levels and subsequent staffing reductions, the programmatic impact will be:

- 82 fewer audits can be conducted.
- 109 fewer investigations can be accomplished.
- $36 million less in fines, court-ordered recoveries and recommended cost avoidances and recoveries will be obtained.
- 112 fewer criminal, civil, and administrative referrals will be accomplished.

The projections are based on historical productivity data maintained by our office over several years, and represents the best information available on which to make such estimates.

On the positive side, however, since we were aware of the reduced levels early during fiscal year 1985, we were able to set in motion a number of actions which will result in our ability to continue to operate with relative effectiveness and efficiency at the revised funding level. There is no question that from these figures we will have reduced audit and, to some degree, investigative capabilities.

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DEPARTMENT OF THE INTERIOR

NATIONAL PARK SERVICE

EXECUTIVE RESIDENCE AT THE WHITE HOUSE

STATEMENT OF MANUS J. FISH, JR., REGIONAL DIRECTOR, NATIONAL PARK SERVICE, NATIONAL CAPITAL REGION

ACCOMPANIED BY:

JAMES I. McDANIEL, ASSOCIATE REGIONAL DIRECTOR, WHITE HOUSE LIAISON

W.C. QUICK, CHIEF, DIVISION OF PROGRAMMING AND BUDGET

INTRODUCTION OF ASSOCIATES

Senator ABDNOR. Our final witness is Mr. Manus J. Fish, Jr., the Regional Director of the National Park Service of the National Capital Region. He will present testimony regarding the executive residence at the White House. It is great to have you back with us.

Mr. FISH. Thank you, Mr. Chairman.

Let me introduce my staff. On your left is Mr. James McDaniel, the Associate Regional Director for White House Liaison. And on your right is Mr. Bill Quick, Chief of Programming and Budget for the National Capital Region of the National Park Service. I have a short statement, Mr. Chairman.

OPENING STATEMENT

Mr. Chairman, I appreciate the opportunity to appear before you to present, for your consideration, the fund requirements for the maintenance and operation of the executive residence at the White House for fiscal 1986.

The appropriation for this account for fiscal 1985 is $4,601,000. We are requesting a supplemental appropriation of $57,000 for 50 percent of the congressionally approved pay increase cost which was effective January of 1985, making a total of $4,658,000 for fiscal 1985. The remaining 50 percent of the pay increase cost is being absorbed.

The fiscal 1986 appropriation request of $4,577,000 is $81,000 below the amount estimated to be available in fiscal 1985. Major changes in the budget include 5 percent reduction in salary costs minus $142,000, and a 10-percent reduction in administrative support expenses minus $57,000, initial funding for two FTE's transferred and partial funding for one new FTE plus $80,000, and the annualization of pay increases effective in fiscal 1985 of plus $38,000.

As part of a continuing effort to assign responsibilities in the most efficient manner, funding is requested for two FTE's transferred to the executive residence during fiscal 1985. One of these FTE's will provide improved coordination of executive residence grounds maintenance. The second FTE will help to provide proper cataloging and maintenance of the growing publicly owned White House fine arts collection as well as assisting with the increasing requirement for information to the public on the executive residence and its fine arts collection. One additional FTE is requested to provide better coordination and communication with the National Park Service in performance of its historic responsibilities associated with the executive residence.

Funding for these FTE's will be partially offset through savings in other operating costs.

Mr. Chairman, I would be pleased to try to answer any questions you may have.

REIMBURSEMENTS

Senator ABDNOR. We notice that the reimbursement account totals about one-quarter of your budget. Could you outline why and how these funds are expended?

Mr. FISH. Yes, sir. The budget that we are asking for the executive residence is the $4,577,000. The reimbursables are estimated at, $1,054,000. Those reimbursables come back to us from the State Department for state dinners. They come back to us from GSA for operating the two wings of the building for electrical energy costs.

They come back from the Department of Defense and the communications agency for electrical costs there, and then in addition, if there are any official functions or rather any ceremonies that are put on by different groups at the White House, the First Family's needs, their food needs, that, too, is reimbursed to this account.

So the $4,577,000 go to the operation maintenance of the residence, and the $1,054,000 are strictly reimbursable.

RESTORATION PROJECT

Senator ABDNOR. You are doing some work there on the White House. How are you coming on that?

Mr. FISH. Mr. Chairman, your committee gave us a couple hundred thousand dollars about 4 or 5 years ago to do some of the painting. As you know, we have been painting the exterior every 4 years for the inaugural.

Five years ago with the money that you had given us, stripped the east face of the White House of all the paint. We had about 32 coats of paint accumulating over the years.

We worked with the National Bureau of Standards prior to that in a study and evaluation, and the method and the paint that they suggested that we use has proven to be very satisfactory. So that the east face last year did not need to be repainted. We just cleaned it.

You gave us additional money then to do the north portico, and I have some photographs of what that looks like. These are the official photographs, Mr. Chairman, I think that it shows you the excellent work that has been accomplished.

We figure that probably out on the north portico there, Mr. Chairman, there may have been close to 100 coats of paint because that area seemed to get dirtier than other areas, and we had to, in-between inaugurals, paint it a number of times. It perhaps was the car emissions or whatever.

ARCHITECTURAL DETAIL OF THE NORTH PORTICO

But you can see in those photographs the excellent architectural detail, the beautiful detailing that was not noticeable because of 100 coats of paint on there, and it just disappeared.

So that right now is airing out and we will start painting that again with the recommendation of the Bureau of Standards.

Senator ABDNOR. That is unbelievable.

Mr. FISH. You could not see any of that gorgeous detailing there.

Senator ABDNOR. That is beautiful. There are no two ways about it. It must have taken a lot of individual work there.

Mr. FISH. We had an excellent company that did that work, and actually they will start painting probably next week, Mr. Chairman.

Senator ABDNOR. Fine. Mr. Fish, you run a fine operation. I do not really have a great many questions for you. I commend you and tell you if we do come up with some additional thoughts or questions we will not hestitate submitting them to you and you can answer them in writing.

We thank you gentlemen for being with us.

I hate to disappoint our audience who just walked in here and I am ready to adjourn this meeting.

WHITE HOUSE HISTORICAL ASSOCIATION PUBLICATIONS

Mr. FISH. If I may, I would like to present you and the committee with the books that are sold at the White House, and these are sold by the White House Historical Association and are available to any visitor through the White House.

The White House Historical Association was set up in 1961 to assist the National Park Service in their programs at the White House, the historical, scientific, and educational programs, and then the proceeds from the sale of these books then go to buy furnishings for the White House, and that organization is headed up by Dr. Melvin Payne and the Executive Vice President, Mr. Bernard Meyer, and they wanted you and the committee to have copies of this.

We also have a copy of the White House history which was just done last year that we would like you to have also.

Senator ABDNOR. Fine.

VISITORS TO THE HEARINGS

For the audience that just came in, this group of young people, I just want them to know that this is Mr. Manus J. Fish, Jr., who is the Regional Director of the National Park Service, and he is in charge of caring for the executive residence at the White House. He has a lot of other responsibilities, too, but in this instance, that is the one we are interested in.

Mr. FISH. I hope they all had an opportunity to visit the White House and the parks in their Nation's Capital.

Senator ABDNOR. Where are you all from?

VOICES. Wyoming.

VOICES. Washington.

Senator ABDNOR. We welcome you all. I am from South Dakota so I do not feel too far away. You have a couple great Senators I work with.

SUBCOMMITTEE RECESS

I am sorry we gave you such a short program to sit in on, but I want to thank our witnesses for their participation today, and if there is no further business to come before the subcommittee, we will stand in recess until Wednesday, May 8 at 2 p.m. when Mr. David Stockman will present the budget request for the Office of Management and Budget.

That is our chance to talk to Mr. Stockman.

Thank you.

[Whereupon, at 3 p.m., Wednesday, May 1, the subcommittee was recessed, to reconvene at 2 p.m., Wednesday, May 8.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

MONDAY, MAY 13, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:30 p.m., in room SD–192, Dirksen Senate Office Building, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, DeConcini, and Proxmire.

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

STATEMENT OF DAVID A. STOCKMAN, DIRECTOR

OPENING REMARKS

Senator ABDNOR. The subcommittee will come to order, and today the subcommittee continues its fiscal year 1986 hearings. We will hear from the Director of the Office of Management and Budget, Mr. David Stockman.

I certainly want to welcome you, Mr. Stockman, and your colleagues. We have seen a lot of each other over the last couple of weeks, and if I do say so, I think we ended up with a very fine budget package.

There may be those who would want to disagree with me but it represented a lot of hard work and a lot of hours. I do not have any other statements.

Senator DeConcini.

Senator DECONCINI. Mr. Chairman, thank you.

Welcome, Mr. Stockman. I am sorry I cannot agree with the chairman about the fine budget, but I do compliment you on the work that you put in and the persistence that you and the majority party was able to deliver a budget as unfair as this Senator may think it is.

Along that subject about unfairness, I do have some questions, Mr. Chairman, that I would like to ask later.

Senator ABDNOR. Fine.

Senator MATTINGLY. I have no comment at this time, Mr. Chairman.

Senator ABDNOR. Senator Proxmire.

Senator PROXMIRE. No statement, Mr. Chairman.

Senator ABDNOR. We will proceed then and let you proceed in any manner you care to. Mr. Stockman.

PREPARED STATEMENT

Mr. STOCKMAN. Thank you, Mr. Chairman. I would like to submit my statement for the record.

[The statement follows:]

STATEMENT OF DAVID A. STOCKMAN

I appreciate the opportunity to appear before you this morning to discuss the Fiscal Year 1986 Budget request for the Office of Management and Budget (OMB).

The President has requested $38,430,000 for OMB in fiscal year 1986. Approximately eighty-eight percent of this request is for personnel compensation, standard level user charges (SLUC), printing of the President's budget, and text and data processing support. An additional four percent of the request is for telephone service, postage, utilities, and equipment rentals. The remaining eight percent of the request is for staff travel and training, background investigations, ADP and other equipment purchases, and office supplies.

The President's 1986 request for OMB is $422,000 (or 1.1%) below our 1985 enacted appropriation of $38.5 million plus a requested pay supplemental of $0.4 million. This request is also $1.2 million (or 3.1%) below our 1986 current services level. These savings reflect our continuing efforts to reduce OMB operating costs by negotiating more efficient financial arrangements with vendors for the delivery of services and by improving the productivity of our staff through automation. With the exception of SLUC, OMB's budget actually declines in nominal terms from 1985 to 1986 in every class of expenditure. In fact, this is reflective of an on-going effort which has resulted in OMB aggregate spending being reduced in real terms every year since 1981.

The 1986 request for OMB continues to reflect our efforts to constrain cost increases while continuing to improve OMB's effectiveness and productivity.

- o Personnel Compensation and Benefits. The 1986 request reflects a net decrease of $369,000, attributable primarily to the President's proposed 5% pay cut. For

1985, the budget requests $352,000 or one-half of the costs of the January 1985 pay increase. The remainder of the increase will be absorbed in our existing resources.

- o Travel. The request is $5,000 less than the current 1985 estimate and $32,000 (9%) less than the original 1985 budget request. Over the last four years, we have tried to make the most of our travel funds by giving funding to new examiners to travel and get first-hand knowledge of their programs. Travel for conferences and other administrative purposes has been kept to a minimum. Our current request level is $85,000 (20%) less than what was spent in 1981.

- o Communications/Utilities/Other Rents. In spite of a mandated increase of $117,000 (or 40%) for Federal Telecommunications Services (FTS) and normal inflationary increases for equipment leases, we are continuing a downward trend in our request for funding of this object class. The request is $696,000 (or 35%) less than what we spent in 1981. Procurement of a new telephone system and other types of leased equipment when it is advantageous to do so have helped us lower the cost of required funding in this area.

- o Printing. The 1986 request continues a downward trend initiated in 1981. Due to increased use of automation and a streamlining of the process we use in printing the President's budget, we have been able to cut costs by $817,000 (48%) since 1981.

- o Supplies and equipment. As with other non-SLUC object classes, the request for office/ADP supplies, other services and equipment has been reduced from our 1985 appropriation level. The planned completion of our new integrated word and data processing system should allow us to continue the downward trend in these costs over the next several years.

SLUC is the only object class where no reduction is planned in 1986. This reflects the fact that OMB has reduced space by 22% over the past five years, and has no excess space to declare at this time.

Another initiative that we are proposing to streamline operations and increase effectiveness is the merger of the Office of Federal Procurement Policy (OFPP) into OMB. We feel this will strengthen OFPP and enhance its stature by integrating it into OMB's overall budget and management reform initiatives. It will also help to reduce administrative overhead costs associated with maintaining a separate organizational entity.

Mr. Chairman, I have attempted to outline some of the measures we have taken to help us absorb cost increases within existing resources and thereby minimize the need for additional funds in

1986. I am committed to reducing the growth of government spending and am holding my agency subject to the same scrutiny that I apply to other Federal agencies.

In 1940, Congress recognized the need to provide the President with limited funds to meet unplanned and unbudgeted exigencies. With the exception of three years since 1962, $1 million in funding has been provided to meet unanticipated Presidential needs. The Fiscal Year 1986 Budget again requests $1 million for the President's Unanticipated Needs account.

Funds totaling $604,000, $223,000, $288,000, $429,000 and $375,000 have been expended from this account in fiscal years 1980-1984, respectively. Extreme prudence is used before making an allocation from this appropriation. Each request is reviewed by our budget examiners to ensure that:

-- the purpose for the funding is consistent with Administration policies and objectives,

-- the estimate of need is accurate, and

-- no alternative source of funding is available.

The request is then sent to the President with our recommendation for action. The President decides whether the allocation will be made. This process ensures that allocations are made only to meet unanticipated needs of the highest priority.

While it is not possible to predict how funds will be expended in 1986, funds have been used in prior years to support Presidential initiatives proposed in response to such unanticipated events as increased drug trafficking and international pressure for U.S. participation in the global campaign for democracy. In 1984, only one allocation was made from the account--$375,000 to the White House Office to provide funding for the transfer of computer systems from the White House Communications Agency to the Executive Office of the President (EOP) Computer Center. No allocations have been made from this account to date in 1985.

I would be happy to answer any questions you may have.

BUDGET REQUEST

Mr. STOCKMAN. In your opening statement, Mr. Chairman, you noted how much you have seen and heard from me in the last couple of weeks, however, on the matter of the OMB budget per se, we can make this relatively brief in terms of what I want to present to you. I know there are other members of the committee who have questions about a variety of other budgets that we have responsibility for and I would be very happy to answer those questions as well.

The OMB 1986 budget request is $38.4 million. That is about level with what we hope will be our funding level in 1985, including the pay supplemental for the increase that went through in January 1985, 50 percent of which we are absorbing.

As I have indicated to this subcommittee before, we have tried to exercise restraint and practice what we preach at OMB. In terms of our own budget request to your committee, $38 million is a small amount in relation to the size of the budget that we are responsible for and that we grapple with day-in and day-out.

Nevertheless, I would point out that if we adjust the budget for inflation, our request of $38.4 million in 1986 compares to an OMB budget of about $46 million in 1980. So over these last 6 years as we have tried to restrain the level of Federal spending and reduce wherever possible the real dollars going into that budget, we have reduced our budget by 16 percent.

We have less than 600 people which is well below the peak levels of the 1970's even though the overall Federal budget continues to grow. As you know, the baseline that we were struggling with last week, even though we disagreed on the final package, everyone felt was too high at $1.1 trillion.

So in a sense, each of our budget examiners now has to cope with $5 billion a year in Federal spending. If we divide total Federal spending by the entire number of people at OMB, including those who work on paperwork and regulatory items exclusively, and are not responsible for the budget, it is well more than $1½ billion per OMB employee.

So I think what I would tell this committee is that in those few areas, since we make no grants, we issue no subsidies, we provide no services, we essentially are the staff arm for the President in attempting to analyze and manage this budget, in those areas where it has been possible to achieve economies, we have done so.

The printing cost is way down because we have automated. A variety of other discretionary costs have been reduced rather considerably. We are left now with a 1986 request, of which 88 percent is for personnel, the mandatory SLUC charge that we must pay, and for printing of the President's budget and text and data processing support. Almost everything else has been cut to the core.

I think this budget request is consistent with what we are trying to do across the board in the budget, and as I indicated previously, represents a substantial shrinkage or diminution, in terms of total dollars in real terms and people that we have at OMB. However, our workload continues to increase each year.

I would like to conclude my comments here and would be happy to answer any questions you have about the OMB budget or any of the other budgets that I know are of great concern to members of this committee.

CUSTOMS

Senator ABDNOR. Well, thank you, Mr. Stockman. Let me start off by pointing out one thing. I have been very proud of the work of this committee and need not tell you about the entire makeup of our funds which are considered as discretionary funds for the most part. We have often said over the last few years that we have slowed down the growth of increase in Government spending and I think an awful lot of it started right here with our budgeting and our committee.

You say you have cut to the core. We pretty well have done that, too. We have some agencies that have, when we redirected the money, gotten awful close to being out of business if we had gone much further, at least to do the job expected of them, and there are a number of areas.

I, too, am concerned but the most important concern that I have is this game we seem to be playing with the Customs Service. Now, the President has declared war on drugs, and yet every year OMB guts the Customs Service budget.

The commissioner is then forced to come and tell us he can do more with less, that automation will do the job. Well, let me assure you I am convinced after my work with Customs that it takes people to do the job and automation is simply a tool to assist. The men and women of the Customs Service do a tremendous job, and it is a tough one that they have to perform.

Every year cargo enters the country and the drug responsibility is increasing also, and this year the budget calls for a reduction of 887 personnel.

I am most attuned to the effort to reduce the deficit. I think I showed that with my votes. But I believe Government does have certain responsibilities to protect its citizens.

It seems to me if we are going to continue the current trend, we should just say to the dopers and other smugglers we give up, do what you want to do.

The committee has heard from many witnesses about the growing commercial fraud in steel and textiles to name just two. We heard about delays in processing because of a lack of manpower.

How can Customs be expected to do its job when we continue to cut? That is a real concern. That is why I have been opposed to talk of a freeze in the budget. There is always that. I just have always felt that there are too many thin areas of Government you should not be cutting.

Certainly trying to counteract drugs and what it is doing to this Nation is one. I hate to put it on the same par with other agencies and other departments but I wondered what your thoughts were on that.

Mr. STOCKMAN. Well, Mr. Chairman, I do not disagree with your fundamental premise that this is a priority activity for the Federal Government that takes both money and people.

But I think we ought to recognize that we have a dilemma here because we have been increasing the Customs budget quite rapidly every year. According to my numbers, the Customs budget in 1980 was $459 million. The appropriation for 1985 was $643 million. So you have had nearly a 40-percent growth in the Customs budget over that 5-year period.

In addition to that, I have not included in this total the separate appropriation account that you have created for the Air Interdiction Program which last year provided $44 million, and I believe we are requesting somewhere around $60 million this year.

So if you look at the total dollars coming in, you are talking about a budget request in the range of $700 million for 1986 versus a budget level before all this restraint and cutback and squeeze on the Federal budget began back in 1981, a budget level in 1980 that was not much above $450 million.

Now, that is a pretty healthy growth in budget resources during that period. I cannot think of any other nondefense agency that has had that kind of growth with perhaps the exception of the FBI and maybe one or two other key law enforcement areas.

I know that the committee continues to feel that we need more, and so we have this debate every year and the committee comes out somewhat higher than our request. But I would just suggest that you cannot automatically throw money at a problem even if it is one as compelling and urgent as the drug problem, the border enforcement problem, or the interdiction problem.

I think we need to take a harder look at where we are spending the money and whether or not some economies can be realized in the Customs agency. The reduction in personnel that we have asked for primarily come out of administrative layers and out of processing offices where we think we can automate.

Now, I know you feel it cannot be done, however, the Grace Commission studied it rather carefully, and they reenforced our position that it can. You know, I am no great expert on this, but I have been led to believe that a $700 million budget for Customs is a pretty good effort in light of the budget limits on the top and the need of pushing up from the bottom.

Senator DECONCINI. Mr. Chairman, would you yield for a followup question?

Senator ABDNOR. Yes.

Senator DECONCINI. Mr. Stockman, what troubles me is you give an outstanding answer that it has increased and we are really going after it, but, you know, the February budget which is probably your doing more than anyone else along with the Senate and the President cut in outlays in law enforcement over $100 million below the 1985 levels toward the administration of justice.

That budget resolution that was passed last week, I think, brings that figure up to 6.7 if my figures are correct, a slight increase over the 1985 freeze level. So your argument here that you are out there trying to do the best you can and it has grown, it has not grown because you have supported it, it appears to me. It has grown because the President says he supports it, and then you submit cuts and then we are left with carrying the load of putting it back on.

If you really support it, what type of war on drugs does the administration have in mind at funding levels with zero growth and cuts of 887 positions in Customs, 800 positions in the Coast Guard, cuts in DEA, and no growth in the FBI?

To me, that is not much of a real strong position. All the nice answers that you give that it grew since 1980, your budgets at least that come up here first of all are always a cut. Now, is that just the game we play? And I understand that game. I was in the executive branch once and I used to play it, too.

But I would much rather know if that is the game, and we will just keep adding it on. But if you are really for a war on drugs, I would like to see it come out of OMB.

Thank you, Mr. Chairman.

Mr. STOCKMAN. Senator, if I can answer that, you know, I really think it is not a game, and let me start with your opening point about the justice function in the budget being cut.

Now, if you will look behind that $6 billion number you will find the reason it is cut, in our February budget, is that we zeroed out the Legal Services Corporation of $300 million, and a couple of other small programs. As a result, the overall function appears that it has been cut or come in below a freeze level.

Now, we have had a long-standing disagreement about the Legal Services Corporation, but I think we can set that aside. What you need to do is look at where was the FBI in our request vis-a-vis 1985 appropriations and was it level or slightly up?

Senator DECONCINI. It was zero, and DEA was cut slightly, and Customs was cut substantially even though you are correct. You did zero out the Legal Services Corporation.

Mr. STOCKMAN. OK. But I think you will see that the other law enforcement agencies, FBI, DEA, Customs, INS, and IRS, if you want to include it, had either level funding in 1986 or some of them were up.

Now, I am almost certain the FBI was up a few million dollars compared to 1985. That is point No. 1.

Point No. 2 is we requested substantial growth in the FBI, in the DEA, and the INS in the previous 2 or 3 budget years. Now, I know everybody always wants to compare where was it last year versus where is it this year and forget the rest of history if it does not make your point. Then you can argue you are not providing enough resources.

But I can tell you, Senator, that the FBI has undergone an enormous steady increase for 3 years, an increase in 1982, a big one in 1983, a bigger one in 1984, and a substantial increase in 1985.

Senator DECONCINI. That is correct.

Mr. STOCKMAN. So over the last 4 or 5 years there has been an increase and we requested it. It was not entirely something that the administration was accepting from Congress. I think the FBI budget is probably up 50 or 60 percent in 1985 compared to the 1980–81 level. DEA is up considerably from the 1980–81 level. INS is up considerably in 1985 with the administration requests.

We then got into the 1986 budget and recognizing all that growth behind us which did some good in that it focused and enhanced our law enforcement resources. However, given the general need to hold down budgets to a freeze level, if we could, prohibited us from having any budget growth in 1986.

Plus as this committee knows we had things like the prison program where we had designed prisons with money in the 1985 budget and had to have increases in 1986 to bring them on stream or to complete construction. Consequently, you will see that our prison request, I believe, is up or is fairly high in 1986.

Senator DECONCINI. But the administration does not abandon the fact that we have a war on drugs?

Mr. STOCKMAN. No; I do not think so, however, if you look at law enforcement resources overall, over a 3- or 4-year path, you see a pretty good record for the Congress in appropriating money and you see a decent record for the administration in requesting it, and I would hope that we could accept that as the basic fact and then argue on the margin over the 887 Customs employees or whatever.

Senator DECONCINI. I am more than happy to argue about those. It seems to me that if you are really going to attack the drug problem that is not the place to reduce personnel, but I made my point and thank you.

Senator ABDNOR. I would like to pursue this a bit more. We have never argued, at least I have not, with trying to cut overhead and particularly the administrative part of it. As a matter of fact, we signed off on a reorganization, I guess we would call it, of the centralized financial and payroll center over at Indianapolis. I think that is fine. I think that involved 280 people.

But we are concerned about line people and things like inspectors where we think it is so important. You can automate all you want to, but you just cannot get around that. As you said yourself, we stepped up the air program.

I cannot think of anything but good about it. It was a good thing we did. When I went out and inspected some of the Customs centers along the southern border and saw the kind of planes they were expected to chase these modern jets with and the kind of equipment they were trying to fight them with it was ridiculous.

I mean, this is too big an item when we are talking about drugs and what little I have seen of drugs and the effects of it and what it is doing to our country, we need manpower. They have a much bigger load than just drugs.

And to try to cut out the line people, your inspectors and all of those kind, I think is a gross mistake, and we have been putting it back, yes, but we have had to take out of other areas of our budget, and that is what hurts because someone else has to feel the effects of it when we do that.

And I think it has been nothing but good, and I have not heard anyone being critical that the Customs are doing too much. I mean, I hear a lot about IRS which I do not agree with, that we would be better off without so many people bugging people, but I never hear that about trying to fight drugs and the inspection through Customs.

So it is a major concern. As a matter of fact, I think I heard that the Finance Committee and also the Ways and Means Committee has restored the whole number in theirs. I am told that Ways and Means not only restored 887 but they have added 800 positions to it.

I guess this is one thing we all feel very, very strongly about, and I just wanted to bring it to your attention. It is a major concern of ours.

Senator Mattingly.

Mr. STOCKMAN. Mr. Chairman, could I make one more point regarding these comparisons that I think is important. All of these agencies, the law enforcement agencies are personnel intensive. Basically we are buying people, agents, support staff, and so forth.

All of our requests assumed the 5-percent civilian paycut in 1986. Since we have now agreed with the Senate on a budget that had no paycut, we will be requesting amendments or we will be proposing amendments to put that money back.

Now, I think if you have an adjusted comparison with the paycut BA put back into these agencies, DEA, FBI, and so forth, you will see that even in a freeze budget, we have come up on a comparable basis significantly in some instances.

And I just wanted to mention that because we will be sending up amendments now that we are having a pay freeze rather than a paycut.

Senator ABDNOR. You are right. That is going to help immensely. I think some of the reasons for the cuts was because of the 5 percent. So that is going to be a big help to us.

Senator Mattingly.

Senator MATTINGLY. Thank you, Mr. Chairman.

Because you are the OMB Director I guess we could get into every facet of the $1 trillion budget that we have. I am not sure that is the purpose of the hearing.

I would like to ask you something directly related to OMB responsibilities. In 1984, the Cabinet council on management and administration, acting on the recommendation of the task force that had been established to examine possible methods of controlling Federal expenditures on consultants and studies, submitted several recommendations, I believe, to the President.

He approved those recommendations which included the issuance of an executive order requiring departments to control the so-called advisory and assistance services which is another term for consultants and studies.

It is my understanding that your office has had the responsibility of following up on the implementation of that executive order. Can you tell me what the status is.

Mr. STOCKMAN. Yes; I do not know the exact last-minute status, but it is in the drafting process, and should be issued shortly. Apparently it has not yet been issued and I am not exactly sure why, but I will find out.

Senator MATTINGLY. Do you know when it is going to be implemented?

Mr. STOCKMAN. We are fully intending to implement it.

Senator MATTINGLY. Do you know when?

Mr. STOCKMAN. Well, as quickly as possible. I was not aware of it until today so I will find out why.

[The information follows.]

It is currently in the drafting process and should be issued by the end of September. Implementation should follow within 90 days of that date.

LOOKING AT LEGISLATIVE ALTERNATIVES

Senator MATTINGLY. It is because you have been preoccupied with the budget that you have not been able to focus on it?

Mr. STOCKMAN. I think that is the case, yes.

Senator MATTINGLY. In view of the delays that have been encountered, do you believe that the Congress should look at legislative alternatives?

Mr. STOCKMAN. No; as I have told this committee before, I strongly urge you to get out of object class budgetting. That is an accounting nightmare that I do not think we can ever adequately deal with, and it drains off a lot of energy and time that ought to be spent on analyzing programs and functions to see whether we need them or we can do it cheaper.

I know there are those on the committee who urge us, and we do what we can, to look at travel and transportation, consultants and other accounts. However, in a $1 trillion budget that has accounts which have been built up since the reform of 1950 by the Appropriations Committees, it is next to impossible to get this giant government of ours to agree on what classes and categories of expenditures fall under the different object class definitions. For example, what constitutes a consultant or what type of travel, publication or printing do you monitor.

Senator MATTINGLY. Well, let us stay with consultants.

Mr. STOCKMAN. I really think it is a dead-end. Last year you mandated the 2901 reductions in these areas, and we had big arguments all over the executive branch about how you define a consultant and how you define travel and so forth.

We targetted 3 billion dollars' worth of savings which you mandated. After a special data call to agencies on base level of expenditures in 1984 and 1985, we spread the savings out by agencies as fairly as possible. However, you know what savings we ended up with out of the $3 billion and even now, is in great contention before your subcommittees

up her. In addition, our recisions have not been passed to carry out your mandate.

I am not sure how this is all going to come out, but it does not look to me like it is very efficacious in terms of getting at wasteful spending.

Senator MATTINGLY. Well, we've been able to establish that the agencies estimates of expenditures on consultants and studies were on the low side to say the least.

Because of the efforts made by me and others, including Senator DeConcini, we have uncovered, I think, a tremendous amount of expenditures that were not previously being included in spend ng estimates.

Now, is your shop aware of the current efforts being made by the Department of Defense to implement some control procedures?

DEFENSE

Mr. STOCKMAN. Well, Senator, I imagine they are, but let's face it. We have focused this defense debate into a top-line issue. What is the real growth rate? Then we delegate it to our authorizing committee, our appropriations committee, the National Security Council and defense agencies to figure out how to spread the dollars that we are willing to make available for defense under that top line.

I think if we are going to have that procedure, and everybody seems fixed on that approach to defense budgetting, I am not sure how much over all intervention on object classes we ought to get into.

They are going to have to squeeze their budget way down due to 0/3 percent/3 percent real growth, and if they want to cut the fat as opposed to the muscle, then they are going to have to go after these categories. There is no doubt about it.

Senator MATTINGLY. The Secretary of Defense has been very cooperative with that effort because, as I think you will recall, last year my amendment froze the level of consultants and studies for DOD at $1.3 billion, just what they had requested.

In fact, what they were really spending was something like $3.9 billion for such activities. The Secretary of Defense is trying to find out where that money was coming from.

Your own figures show that the great majority of all Federal expenditures for studies and consultants is done through DOD. I am just pointing out that if we are to control these costs, we must focus on defense.

Mr. STOCKMAN. I know you feel strongly about it, however, I am not sure that it is a very meaningful category to analyze as far as where the defense dollars are going.

For example, on the one hand, we are pushing defense to do more A-76 or contracting out. Many of those consultants could well be in-house employees doing the same study that may or may not be necessary, and it is a question of whether it is being done in-house on the payroll or on the outside with a contractor.

But the more we push them to contractors, which I think is efficient up to a point, the more money you are likely to have showing up in any category called consultants and studies. However, there is no func-

tional difference between an in-house study and a consultant study except whether the guy is on a contractor payroll or the DOD payroll. The real issue is whether the study is necessary, not which payroll is he on.

And I do not think you will ever corral anything in terms of excessive defense spending by looking at an object class. What you must do is look at the content of what we are buying, what our programs are, what our objectives are and whether we are doing it efficiently.

Senator MATTINGLY. But you and I both know unless you question these expenses or question the costs you are not ever going to corral it. It has become a way of living in the beltway area for a lot of people.

Mr. STOCKMAN. I agree.

Senator MATTINGLY. You have been very cooperative in trying to control these costs. Until we started our efforts, we did not even know exactly how much was being spent.

We need to insure that these types of expenditures be justified or else identified or eliminated.

Thank you, Mr. Chairman.

2901 REDUCTION

Senator ABDNOR. Before we go on to Senator Proxmire, I just want to note that I have reviewed the 2901 reduction proposal and some of them are pretty tough cuts. I personally am going to recommend that the subcommittee approve these recissions.

I also want to ask you. You mentioned a moment ago the 5 percent dollars added back that we did not go along with in the budget. Will we see a written request from you to add those dollars back in the same way that the other dollars that were restored will be reviewed?

Mr. STOCKMAN. At some point we will send up an omnibus amendment to the 1986 budget that includes that. I believe we have sent the subcommittee staff, or your full committee staff, a list of where all those 5-percent reductions are by account, the FTE dollars involved, and we could, I suppose, transmit a supplemental to make it official.

But your committee staff knows where the dollars are and what should be added back.

Senator ABDNOR. Just so we have some official word from you or from your agency.

The last thing. Section 515 of the fiscal year 1986 Treasury bill requires the 10-percent reduction in consultant and related expenditures. Could you provide for the record the list of the funds which have been withheld?

Mr. STOCKMAN. Yes; I would provide that for the record.

[The information follows:]

Here are the savings we have proposed:

Travel and transportation	$100,000,000
Consultant services	149,000,000
Publishing and audiovisual	71,000,000
Motor vehicles	94,000,000
Public affairs	23,000,000
Total	437,000,000

OMB BUDGET

Senator ABDNOR. Senator Proxmire.

Senator PROXMIRE. Thank you. Mr. Chairman.

Mr. Stockman, our immediate objective here is to determine the justifications for the money being spent by the Office of Management and Budget, OMB, and I do not mean to be critical of you because I have, like everybody else in Congress, great admiration and respect for your ability.

In fact, I have so much admiration and respect for your ability that I cannot understand why your staff has to be so big. It seems to me that you could do the whole job yourself. I mean that honestly. There is nobody who has appeared before us, with the possible exception of Secretary McNamara, who appeared 20 or 25 years ago, who seems to be on top of things the way you are.

Therefore, I want to ask you about your office staff. Your office staff of 72 positions is only 8 less, as I understand it, than you have in the entire National Security and International Affairs Division, the division that reviews the defense and foreign aid budgets, and funding for your office is nearly $300,000 more next year than funding for the entire division that reviews the Medicare, Medicaid, nutrition, health and the entire Department of Health and Human Services.

It seems to me that you are topheavy in your own personal staff. Why is that?

Mr. STOCKMAN. Well, it is not really personal staff. That may be the classification but that includes all of the administrative staff of OMB, the legislative liaison, the General Councils Office, the Public Affairs Office, and the Office of Economic Policy all of which do not fit neatly into the four functional program divisions of OMB. We have organized it that way for budget display, but it does not involve any more people than were ever there before. We just grouped them into that fifth category.

I can provide a breakdown for you, but I can assure you that it is not topheavy.

Senator PROXMIRE. Well, I would like to see a breakdown that way, because it seems to me if you cut your staff by 25 or 30 percent and allocated the personnel to these other categories that you might have a more efficient operation.

As I say, you are obviously the kind of director who does not need all kinds of people putting figures in front of you. You have them all in your mind more clearly than your subordinates I am sure.

Mr. STOCKMAN. Well, Senator, I would just say, yes, I try to retain a lot of figures, but the frustrating thing about this budget is every time

we take another step in the process all the numbers change and we move from House Appropriations to Senate Appropriations. We reestimate the budget at midsession. We get some legislation and by September the numbers have changed again. You need a lot of people to constantly track these numbers and translate them from where they were last time you looked at them.

These changes are not large amounts. They usually do not have any significance in terms of policy direction, but they are constantly moving, and you have got to be able to answer questions on these changes and reconcile to where you were before.

We have automated OMB so that everybody can talk to each other on the same computer now. We did not have that before, and I think if you take a look at what has actually happened down there, you can see that we are getting a lot more output from the same number of people, in budget dollars, than we had in the past.

Senator PROXMIRE. I will tell you where I am coming from. The other day I read a speech, a report of a speech by Secretary Lehman, the Secretary of the Navy, who pointed out that the Defense Department, the Office of the Secretary of Defense, started out when there were more people in the military than there are now because it was created, as I understand it, right after World War II, started out with 50 people and now it has 2,000.

He pointed out that the Joint Chiefs of Staff started out with 100 and now has 2,000. There seems to me to be a tendency to concentrate enormous staff, unwieldy staff in various agencies; 72 is far from 1,000 or 2,000, but it seems to be disproportionate in view of the fact that the rest of your operations are lean and hungry.

Mr. STOCKMAN. Well, let me submit something for the record. I really think it is an illusion due to the way we classify our staff. Normally, I go directly to the budget examiners, to the divisions you are talking about for the numbers and talking papers I want. The 72 people that are involved, in what is called the Director's office, are all the various support functions that we have at OMB.

[The information follows:]

What we refer to as the Director's office is really a composite of the Director's immediate staff as well as support staff in the areas of administration, public affairs, congressional and legislative affairs, economic policy, and General Counsel's office. The 72 staff positions within the Director's office are broken down as follows: Director's office, 20; administration, 12; public affairs, 3; congressional and legislative affairs, 8; economic policy, 13; and General Counsel's office, 16. I would like to add though, that in real dollars, the Director's office had the second largest decrease of OMB's eight program areas for the period 1981-86.

OMB WORKLOAD

Senator PROXMIRE. Let us take one particular area, your Legislative Reference Division. The workload in that division has been sharply declining since the 96th Congress. The total volume for the division has dropped from 11,621 items in the 96th Congress to 8,481 items in the last Congress, a drop of almost 27 percent.

Yet I notice that your staffing for the Legislative Reference Division has remained steady at 29 full-time positions. Why not cut back your Legislative Reference Division next year to reflect the significant drop in workload experienced in the division over the past several years?

Mr. STOCKMAN. Well, first let me say that the Legislative Reference Division is entirely a professional staff at OMB. There is not one appointee or political type there. That was the backbone of the old Bureau of the Budget. The notion of central clearance goes back into the 1930's or even before.

They do a lot more than what those statistics will indicate, such as, reviewing bills introduced into the Congress. There is an increasingly difficult problem of clearing testimony, because there has been a proliferation of subcommittees, oversight committees, and so forth, and on any given day more and more administration witnesses from deputy under secretaries all the way up to cabinet secretaries are testifying.

Most of that testimony is cleared through the Legislative Reference Division. The same is true with the volume of communications, written communications going to the Hill about the administration's position on pending bills. All of that written communication has to be cleared through there.

So it is really the switchboard of the executive branch in terms of clearing communications with the congressional branch on policy positions that the administration has.

Even though one of the workload measures may quantitatively change from year to year, I can tell you the volume of real work there as this Government gets more hyperactive and more players become involved, has grown.

I do not know which measure you are using, however, I will look it up.

Senator PROXMIRE. Well, on page 15 of your justifications it says, "Agency reports and testimony for clearance, 96th Congress, 6,738; 97th Congress," went down to 4,500, and 98th Congress was 4,400. You had fewer reports and testimony for clearance than you had and considerably fewer.

Mr. STOCKMAN. Well, let me look at it. You may have a point, but when you are measuring something like reports and testimonies, it may not be appropriate to assume one report takes 15 minutes on average. For example, clearing something on superfund is a lot different than clearing a routine report such as the energy conservation targets for the electrical generation sector that we have to send up here every year.

I can tell you I know that the amount of business, the amount of policy struggles and communications going on in the executive branch, both internally and with the congressional branch, has grown even though some of those quantitative indicators do not appear to suggest that.

Let us analyze the numbers and send it back to you because I know they are overworked.

ECONOMIC ESTIMATES

Senator PROXMIRE. A lot of people have been very critical of your economic estimates, including Senator Chiles who is our ranking member on the Budget Committee. You have estimated a growth of 4 percent and based your estimates as to how big a deficit we are going to have over the next few years on a growth of 4 percent in real terms of the economy.

As you know, in the first quarter, we had a growth that was much less than that, only 1.3 percent as I understand it in real terms. Productivity fell to 1.2 percent in that period. Corporate profits have gone down.

Most of the independent observers seem to feel that that is very optimistic, that we will not have a 4-percent growth. Now, say that slides by 1 or 2 percent, and we have a 3-percent growth or a 2-percent growth.

What will that do to the deficit? Will it not have an effect next year and the year after that will be substantial? It would mean we would have a much bigger deficit than is projected at the present time?

Mr. STOCKMAN. Senator, it could, but there are two key points to keep in mind. One, it depends on whether that happens for one quarter, for 1 year, or whether it happens during each of the next 4 or 5 years. If it is only one quarter of 1 year, it would have relatively small effects. When you hear that a 1-percent change in the growth rate will have an effect of $80 or $90 billion by 1990, it is assuming that it is 1 percent less every year not simply for a short period of time.

The second thing is that it depends on whether that 1 percent lower growth comes out of nominal or real GNP. This is a point I have been trying to drive home up here and I do not think I have been very successful.

For example, if we are assuming, that real growth for this year will be 4 percent and inflation will be about 4 percent, nominal then growth would then be 8.2 percent. That is what drives your revenue base. We do not tax real GNP. We tax nominal income, even if we do have the Tax Code indexed.

Therefore, if we have 1 percent less real growth, and that is offset with 1 percent higher inflation so the combination is not 4 plus 4 percent but 5 plus 3 percent; the budget will only be moderately affected because the nominal growth will remain at 8 percent.

On the other hand, if we have 4 percent inflation; 3 percent real growth and nominal growth of only 7 percent, then the budget will be heavily affected because the income base of the economy is smaller and revenues will be down considerably.

So my point, therefore, is how many years do you expect this shortfall to last, and is it coming out of the real side or the nominal side? If you expect it to last over several years and to come out of the nominal side, you will get big deficit increases by 1987, 1988, and 1989. If you expect it to come out of the real side and only be a temporary thing, the deficit change could be less than $10 billion.

Senator Proxmire. There are several reasons why we should expect, logically expect the growth in the economy would not be 4 percent. One is that historically it has been about 3 percent in real terms, and you are, therefore, a third higher than the experience we have had in the past.

And of course, another is that we are coming off a terrific stimulative effect, coming off a period of a huge budget deficit which tends to stimulate the economy, and if we are reducing the amount of resources going into stimulating the economy, it seems to me we should expect not an increase in growth over the historic average but a decrease.

In other words, we should not expect 4 percent which is much higher than it has been in the past. We should expect it might go down to 2 percent.

Mr. STOCKMAN. Well, again, I think it depends on nominal and not the real growth rate. Historically, you can make a case that 4 percent is pretty optimistic.

But what drives nominal growth, in my view, is primarily monetary policy. We are assuming 8 to 8.5 percent nominal growth in 1985 over 1984 and 1986 over 1985. That does not require excessive money growth.

In other words, in the last six or eight months, money supply has grown at an annual rate of 8.5 percent. Even if there were zero velocity growth, we would still get nominal GNP of 8.5 percent, and that is exactly what we are assuming in the budget.

I expect we will get some velocity growth even though it may be a little bit below average. So if you look at it that way, it is very reasonable to believe that you can get 8 to 8.5 percent nominal GNP growth over the next couple of years. That will produce the revenue path that you see in our budget.

The question is: Will we get the mix of 4 percent real and 4 percent inflation; or are we going to end up with less real growth as you are contending and more inflation? There is always the risk of the latter.

But in terms of the budget estimates, we are gearing them to a nominal growth in the economy that is very consistent with the rapid money growth that we have right now and that we have had for the last year and a half.

Senator PROXMIRE. That is all, Mr. Chairman.

OMB REDUCTIONS

Senator ABDNOR. Staying on your own budget, I would like to ask you, Mr. Stockman, the OMB object classifications are reduced in every area except SLUC. Now, this is most commendable. How have you been able to accomplish this?

Mr. STOCKMAN. Well, let me give you one good example, the printing of the President's budget. Because we have totally automated the production of the President's budget document we have cut printing costs by 50 percent since 1981. That is a case of pure productivity using modern technology to reduce costs.

The problem with this process is a peak workload problem. All of the decisions are usually made on the budget by January 15, and then about 10 days later we need to have 1,000 or 2,000 copies of that massive document up here.

Well, in the good old days you used to pay printers overtime to print around the clock so we could get this budget out and it was extremely expensive.

Now, that we have automated this production process, we have been able to cut back enormously on the production cost of the budget. That is one example of how we have reduced our expenditures for printing.

Senator ABDNOR. It has been brought to my attention that I skipped the distinguished Senator from Arizona. I will finish up with this question.

Tell us about the communications and utilities classification. How have you been able to reduce that? Almost every other agency in Government is requesting significant increases in that.

Mr. STOCKMAN. I will submit more detail for the record, however, we have taken advantage of good buys in the market and purchased a lot of equipment because we found that the life cycle cost of purchasing was much lower than the rental cost that we were previously paying.

As a result of those purchases, our rental costs have decreased as we have tried to automate and update all of our equipment.

[The information follows:]

In spite of increasing costs for telephone service and equipment rentals, OMB has been able to substantially reduce costs for the following reasons: (1) OMB procured a new telephone system rather than continuing to lease the old equipment. This resulted in substantial savings over the life of the equipment. (2) OMB has exercised the option to buy much of our office equipment rather than continuing to lease. In many instances, these procurements have saved OMB substanital amounts of money.

WIC PROGRAM

Senator ABDNOR. Well, the thought occurs to me that you may want to look at some of these other agencies because they have great increases and you might have something you can suggest there in that area for the other agencies.

Senator DeConcini, I am sorry.

Senator DECONCINI. That is all right, Mr. Chairman. I interrupted you there on that law enforcement.

Mr. Stockman, quickly let me turn to the WIC Program. In the continuing resolution of fiscal year 1985, Congress appropriated $1.5 billion for the program. The conference report that accompanied the 1985 agricultural appropriation bill which was molded into the conference report expressed the conferees intent that the WIC Program be carried out in such a manner as to fully obligate the $1.5 billion.

In addition, the conferees stated, "Any action to allocate funds inconsistent with the full-year appropriation level of $1.5 billion would be an improper withholding of funds."

OMB has not allocated for distribution to the States the full amount based on $1.5 billion annual appropriation in any one of the first three

quarters of this fiscal year. How do you reconcile the position that WIC funds are being apportioned to the States in accordance with the public law?

Mr. STOCKMAN. Well, Senator, if I may give the background, on this appropriation which was different from the normal process. Rather than being up front and appropriating $1.5 billion for WIC in the normal manner, a lesser amount was appropriated, and then the appropriation language said, "But an amount for up to a total of $1.5 billion"—I think it was $250 million—"shall be available if requested by the administration."

Now, that was part of a game played by the House Appropriation Committee chairman so that he would not have to rack up his appropriations bill and show that he was over the budget ceiling, over the President's budget.

We thought that Congress was tentative about that appropriation because you did not put the $1.5 billion for WIC in there the normal way. Since the appropriation was actually $1.254 billion it was not exactly clear what the intent was. My view was that the intent was to maintain the caseload as it existed at the end of last summer.

Now, the caseload at the end of last summer was about 3 million. So when we sat down to submit the 1986 budget and carry out instruction of the appropriations bill, we requested the amount that would be necessary for the fiscal year in order to continue a caseload of 3 million. This amount was slightly under $1.5 billion, I think $100 million under that.

Now, people are saying, "No, that was not our intent at all."

Senator DECONCINI. Well, Mr. Stockman, let me interrupt you, and I understand that there was a game going on there, and I appreciate—I do not appreciate it. I realize it was there.

But it is so clear to me in the law that we passed that says, "Provided that funds shall be apportioned to the States based on an annual appropriation level of $1.5 billion." It seemed to me pretty clear that that is what you were directed to do by Congress.

Now, if you run out of money in the last quarter and we did not appropriate any, there would not be any or there would be very short quarter. The problem is we have 230,000 women and children as a result of the action of your interpretation which seems so clear to me, and I just have a hard time believing that you want to do that in light of this very, very direct language that it shall be apportioned based on $1.5 billion even though only $1.3 billion was actually put in the bill.

Why struggle with that? Why go through that?

Mr. STOCKMAN. Well, Senator, you are raising a good question, and maybe there is some information I could provide to you that other staff have not provided. You have got to decide whether you want WIC to be an entitlement or an appropriated program.

Basically, it is now running on a kind of hybred basis somewhere inbetween. But we have seen constant escalation in the WIC caseload every year since 1980. We had less than 2 million on the WIC caseload

in 1980 and 1981. We are now at 3 million which is a 50-percent expansion of the program over the last 4 or 5 years, and I will not argue whether that is good or bad.

From a budget point of view, it is more costly. From meeting the needs and making sure that we achieve our goal of getting the infant mortality rate down and so forth, it is desirable.

But I can tell you what happens. Every year it is not clear what Congress intends to do in October in the Agriculture appropriations bill on WIC because of this game playing, appropriating for 9 months or pretending that you have a $1.2 billion budget when it is really $1.5 billion.

And we find that in the first couple months of the fiscal year the caseload suddenly escalates over where it was before. I can prove to you that the caseload at the end of 1985, last summer, was 3 million, and lo and behold, the October, November, and December numbers come in and it is running more like 3,112,000 or something like that, 3,150,000.

The issue then becomes whether you are appropriating whatever the caseload turns out to be. That is an entitlement, like food stamps. Or are you putting in a budget amount and then allocating it to the States and telling them to serve whom they can.

Senator DECONCINI. Yes; but, Mr. Stockman, is not clear that when the Appropriations Committee says to apportion it on the basis of $1.5 billion that that is really what you ought to do, and then when you run out of money, if Congress does not come in with the balance of the money on their own or if you do not submit that you were directed to do, is not that the time to confront us with this question?

I just pose that. You do not have to answer. I just wish you would think about it, and in light of the Senate passing a sense of the Senate on the budget that finally passed the Senate here, 97 to 0, urging you to go back and do this, can we look for any change in OMB's policy decision now on the balance of this fiscal year?

Mr. STOCKMAN. Well, you know, it is pretty clear to me what Congress decided for 1986 and what the sense of the Congress was for 1985 so I imagine that the rest of this money could be released.

We are being gamed here from both sides, and frankly, I do not appreciate the practices of all these lobbies and interest groups out there.

And on the basis of a 1- or 2-month caseload, October and November, which somehow the States always manage to increase, a new plateau or a new annual level for this program is created. As a result, we are always short of appropriations and people think OMB is doing something that is short changing the program.

Now, I think it is time that we had a little conference between the authorization committee and the Appropriations Committee and decide that if this is to be an entitlement, then let us have another entitlement. Fine with me.

Senator DECONCINI. Well, Mr. Stockman, I can understand your frustration, but this is not a lobbying group. This is Congress voting on a law that States apportion it based on $1.5 billion.

Mr. STOCKMAN. No; you did not, Senator. I do not want to quibble with you, but you did not appropriate $1.5 billion. You appropriated——

Senator DECONCINI. We told you to apportion the $1.3 billion, whatever it was, that we did appropriate based on $1.5 billion.

Mr. STOCKMAN. That was in the manager's statement.

Senator DECONCINI. That was incorporated in the law, Mr. Stockman.

Mr. STOCKMAN. I am not sure about that, but I will check.

Senator DECONCINI. Well, I wish you would look. If I am mistaken, so be it. My understanding is it is folded into the public law.

Mr. STOCKMAN. Senator, my understanding, and I will go back and check it——

Senator DECONCINI. I wish you would.

Mr. STOCKMAN. My understanding was that our request in the January budget, our 1986 budget, would serve as an automatic supplemental appropriation. In other words, the way in which that appropriations bill was written only provided $1.254 billion, but then it said, "If the administration transmits a request for more in 1985, the additional money would be automatically released." But it did not indicate that we had to transmit a request for the difference between $1.5 billion and the actual level that was appropriated.

Now, if my understanding of this situation is wrong, then we will go correct it, but that is my clear understanding.

Senator DECONCINI. Let me just refer you, for your purposes, because we could argue for some time here, page 20 of the public law, at the top of the page here it seems very clear to me, and maybe you have not had a chance to read it.

I think now in light of the Senate passing the sense of the Senate that hopefullyyou can release that money and we will proceed with the supplemental.

I have another question if I have time, Mr. Chairman.

Senator ABDNOR. Go ahead.

Senator DECONCINI. On the line that Mr. Proxmire asked you regarding your budget now, and I realize as Senator Mattingly pointed out that is really what this is all about, but the trouble is that OMB gets into so many policy decisions that it affects us in almost every area.

But as to your budget, the President's original budget and now the compromise budget cuts a lot of program—Amtrak, Job Corps, postal subsidy, DEA, UDAG, rural housing, just to mention a few, and even though you are recommending wholesale cutbacks in these programs, your OMB staff remains pretty much just the same with a slight reduction in funding, but still at 594.

Since you and the President feel that a dozen or so programs should be terminated or substantially phased down, why should not this committee terminate or phase down the examiners at OMB that handle these programs?

What I would like you to provide for the record later is what would be the impact on OMB's operations if we were to cut your staffing by

10 percent down to the 534 positions and roll funding back to a level of $36 million in fiscal 1986.

And I would like you to be specific as to what programs would be affected if that happened to you. But can you tell me? You are cutting these programs. It looks like that is where the budget is going to end up, substantially cuts if not elimination. Why cannot you reduce your own budget?

Mr. STOCKMAN. Well, let me give you one example, Senator. We have one examiner, a little girl that works day and night on the whole SBA. We have 5,000 people over there. There are dozens of paid lobbyists in town who spend all their time trying to keep SBA programs alive.

Here is this one little girl who works on SBA, and when I had to testify before the Senate Small Business Committee proponents of SBA were lined up all the way back to the wall. They were there to cheer on the committee and keep SBA alive. The whole SBA staff was sitting up there for the Senate committee.

And this poor girl had to stay up all night and draft her husband and they worked all weekend trying to get my testimony done in time so I could come up here and face the people at the podium and all the people behind me who were for keeping it alive.

Now, sir, I want to tell you that this is the situation, case-after-case. I have one person to fight Amtrak. They are using public money and Amtrak President Claytor is running around organizing all the passengers, thousands of dollars and hundreds of people, and I have one little girl working and trying to answer all of their charges.

[The information follows:]

A 10-percent cut to the number of OMB positions, as well as our level of funding would severely impact every area of OMB operations. Every program activity would have to be reduced to absorb a cut of this magnitude. Even though OMB's workload has been increasing over the year, we have tried to reduce our cost of operation. For example, the number of full-time permanent staff has been reduced by 88 positions—or 13 percent—since the late 1970's and our appropriation, in real terms, is down approximately 16 percent from our 1980-81 level. This decrease has occurred even though many of the cost increases during this period were mandatory. For example, increased SLUC rates have increased our costs $2.3 million—or 84 percent—over the same period.

OMB is constantly trying to reduce costs whenever possible. Examples of our efforts in this area follow: (a) Our current request for travel funds if $85,000—or 20 percent—less what was spent in 1981. (b) Our request for funds in the area of communication, utilities, and other rents is $696,000—or 35 percent—less than what was spent in 1981. (c) Our request to fund printing activities such as the President's budget has been decreased by $817,000—or 48 percent—from what we spent in 1981.

I believe this reflects fairly well on our efforts to reduce our own operating costs whenever possible.

PROGRAM CUTTING

Senator DECONCINI. I surrender.

Senator PROXMIRE. How big is she?

Mr. STOCKMAN. Well, between the two of them, they probably average about 5'3".

Senator DECONCINI. Mr. Stockman, do you feel that cutting our programs or substantially reducing them does not equate to the size of your staff? The Appropriations Committee here we handle $13 billion. We have two full-time staff people.

Mr. STOCKMAN. We will get rid of the SBA examiner once you get rid of the agency. I can tell you that.

Senator ABDNOR. Let me finish the other half of this question. I did want to get into the specifics of your agency. Now, OMB has reduced space by 22 percent over the last 5 years and no further reduction is scheduled apparently in the 1986 fiscal year budget.

Does this mean you have reached the goal of 135 square feet for each employee?

Mr. STOCKMAN. No; I do not believe that we have or that we probably will because what balloons our number is the fact that we have a few big offices over in the second floor of the EOB where the policy staff operates.

I think if you look at our professional staff, our career staff, they are probably pretty close to the 135, but my office blows that by a factor many times greater. Now, if you want to cut my office in half, that is fine. I could live with it.

Senator ABDNOR. What I want to say is GSA tells us they are having problems in getting agencies to adhere to this level of space. I do not know how we arrived at that 135. Obviously there are always those who require bigger offices, but we are talking about the average employee here, and it is something we ought to strive to do.

Do you have any ideas of how we can do this without destroying the necessity of larger offices for those who need them? We have to figure out someway to help the GSA get that down to 135.

Senator ABDNOR. Think about it.

Mr. STOCKMAN. All right.

Senator ABDNOR. We are always renting more space, and if we can get more people to handle the jobs with less space, we ought to be doing it.

Senator Mattingly.

Senator MATTINGLY. How are the wife and baby?

Mr. STOCKMAN. Fine. I do not want to start a story there. [Laughter.]

Senator MATTINGLY. OK. I would just say that whatever the budget is for OMB, I think you deserved it with the passage of that budget resolution this past week. I think it was well worth the effort involved.

I think your efforts will benefit the whole country. I thank you for that.

Thank you, Mr. Chairman.

INTERSTATE COMMERCE COMMISSION

Senator ABDNOR. I am slipping in a question here for Senator Andrews. He wants it for the record. The fiscal year 1985 appropriation for Interstate Commerce Commission salaries and expenses is contained in Public Law 98–473 was $48 million.

The Office of Management and Budget apportionment granted the commission's first quarter spending authority for the entire sum. Why did OMB grant this category of apportionment, all of it in one quarter apparently.

Mr. STOCKMAN. Well, I would have to check the reasons why the apportionment was made, but we felt last fall that the cut was so deep we were going to have to ask for a supplemental, which we have. I know there is some disagreement with the subcommittee, but there are many others including the authorizing committee who feel the supplemental is justified.

We are now at the point where the agency is out of money, and they are on a 1-day-a-week furlough I believe, and I think the $1½ million or whatever is involved is probably necessary.

Senator ABDNOR. The second question he wanted to ask is the Commission's rate of spending in the first quarter has necessitated a supplemental appropriation request as well as employee furloughs.

In what way did OMB let the Interstate Commerce Commission know it had to curtail spending to live within its appropriation?

Mr. STOCKMAN. Well, I think we indicated last fall that we felt that appropriation was too low, and we decided then that we would seek a supplemental and there is always a risk that the supplemental would not be granted, although I think the record is about 98 percent approval of supplementals.

So on that basis, we apportioned in a way that would provide ICC management with maximum flexibility to make quick changes in allocating its resources while making it clear to the Commission that it was expected to live within its appropriation.

Senator ABDNOR. Did you encourage them to reduce the employees' furloughs if they had to?

Mr. STOCKMAN. I am not sure what went on there.

Senator ABDNOR. Could you give us more detail on that?

Mr. STOCKMAN. I can get something for the record, yes.

Senator ABDNOR. Senator DeConcini.

WATER PROJECTS

Senator DECONCINI. Thank you, Mr. Chairman.

Mr. Stockman, let me say that though I picked on the poor young girl at OMB that was not my intent to pick on anybody including yourself. I have to agree you do a good job at OMB as much as it frustrates me.

I am going to ask some questions that are so frustrating to a Western Senator. You can imagine the subject matter, being water. I am aware of the role OMB plays in the formulation of this administration's water policies. Whether we are talking about flood control projects, reclamation projects, or funding for sewage treatment plants, communities around this country, particularly those in the West, are aware of the growing influence that the Office of Management and Budget has.

We have pretty much resigned ourselves to the fact that State and local contributions to the total cost of construction of water projects is going to be compulsory for these projects to be completed and certainly for any new ones.

The question is not whether there will be cost sharing but how much and from where, and I would like you, if you can, Mr. Stockman, to tell us where you expect communities to raise the funds for water project financing purposes.

It seems to me that, on one hand, we are limiting bonding capabilities; on the other hand, in Western States, we have a limited amount of taxable land, in Arizona less than 15 percent of the land is privately owned.

I wonder in your process of water policy and cost sharing if you ever confront the problem of some of these States that differ with other States that might have a better taxing capacity.

Mr. STOCKMAN. Well, Senator, I think that is important to look at. I do not have any specific answer on the Arizona situation as to how that contrasts with other States. I do not believe, though, where you are talking about clearly Federal land, that we have indicated at least for the Federal lands or Indian land share of Federal projects, that these cost-sharing requirements pertain.

The local components claim these projects are economical, desirable, and valuable. Who can ever judge that. It is hard to sit here in Washington and know. It seems to me that requiring some earnest money at the local level, sort of, what are you going to invest if this distant money from Washington funds the rest, is a pretty good test, pretty good proxy to determine whether the size and scope of some of these projects is really as beneficial and desirable as claimed.

Now, we can carry it too far and then lead to a result that I know you do not want, but at least if we use a flexible standard of some local contribution, depending on the type of project and the circumstances, we can ask people to say; "Do we really want this?" It is not usually "yes" or "no" on the project. It is how big, and how elaborate, and do you need the extra four or five segments.

And that I believe that our local cost sharing standards have an important role in answering these questions.

WATER DEVELOPMENT POLICY

Senator DECONCINI. The Reagan administration's policy on water development has been explained in the so-called Laxalt letter of January 1984. That letter basically states that cost sharing will be a necessary element for Federal project funding.

If we take a look at the 1986 budget request for the Bureau of Reclamation, it appears that at least for the State of Arizona funds have been requested for studies where local sponsors have agreed to pay 50 percent of the study costs.

I did not see any explanation in the Laxalt letter on the policy of this administration with regard to 50 percent cost sharing or feasibility or not planning studies.

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Am I correct in assuming that it is the policy of this administration that prior to any feasibility studies local sponsors must agree to pay 50 percent of the total study cost or is that still on a case-by-case basis?

Mr. STOCKMAN. Senator, I would have to check and submit for the record. I do not believe that is an utterly inflexible rule, but I think it is a general target.

Senator DECONCINI. Would you mind submitting that to us?

Mr. STOCKMAN. Yes.

Senator DECONCINI. I would appreciate it.

[The information follows:]

As stated in the Laxalt letter, "The costs incurred by the Federal Government in project planning generally will be shared with project sponsors." The administration's policy is to approach cost sharing for planning studies on individual projects on a flexible basis. However, the administration has set an overall goal of 50 percent cost sharing for new planning studies.

CASE-BY-CASE RECLAMATION PROJECTS

Senator DECONCINI. I have another question which I have repeatedly posed to our Interior Secretaries. I cannot say that I have been pleased with the reply so I would like to ask you the same question.

I have been told that with regard to reclamation projects that this case-by-case review on cost sharing applied only to new projects, not to those that are already authorized and ongoing.

Yet in the case of the central Arizona project, we have been faced with a policy decision by this administration that states we must cost share on the regulatory storage elements of the CAP known as plan 6.

As you understand this administration's water policies, Mr. Stockman, how would you explain the fact that Arizona is being asked to cost share with upfront financing on plan 6 of the central Arizona project that is already totally authorized?

Mr. STOCKMAN. Senator, again, let me check that, because I do not remember the exact details of the central Arizona project, but I think we have made a clear indication that where projects are authorized or segments are authorized but they are not yet currently into construction and funding that our cost sharing standards would apply.

There is a lot of authorization on the statute books that go back 30 or 40 years where projects are not underway today, and I do not think that all of those ought to be exempted just because they were put on the statute books and sat there idly for 30 years.

[The information follows:]

It is administration policy that authorized projects or separable segments of authorized projects that are not under construction should be subject to the same cost-sharing standards as other new construction.

Plan 6 of the central Arizona project is a completely separable component of the CAP. Plan 6 required a complete and separate feasibility study and environmental impact statement, and includes construction of facilities that were not included in the original CAP authorized by Congress. In addition, the cost of plan 6 is significant; adding yearly $1.5 billion to the total cost of CAP. This component of CAP is not under construction. The administration believes, therefore, that the non-Federal sponsors should participate in financing plan 6 according to current cost-sharing standards.

ONGOING PROJECTS

Senator DECONCINI. What about ongoing that were under construction?

Mr. STOCKMAN. Well, for those that are ongoing, and have been funded we would not apply cost sharing, however, projects have a way of extending themselves and developing a segment 3, segment 4, segment 5, and so forth. I do not believe that we have grandfathered entirely new segments, but again, I would have to check that.

Senator DECONCINI. One more question here, Mr. Chairman. Then I will submit the balance.

Mr. Stockman, I cannot help but believe that you have some animosity, I get a feeling, toward reclamation. I hope you can put us at ease here that that is not the case. Let me just show that whether it is in the form of the safety of dams or water division projects that they should not be a priority of the Federal Government and this administration.

The President and Secretary Hodel and previous Secretaries of this administration have been very forward in saying that it is a priority subject sometimes to the budgetary restraints but it is a priority. They are committed to the development of water projects.

You have just demonstrated your negative feelings about reclamation in the case of Arizona through the lengthy deliberative process in the safety modification report for certain dams in Arizona indicating that the CAP authorization ceiling should be raised by the Congress.

I want to thank you for whoever influenced you to change that position because it is clear that that authorization is already in the law and need not be increased.

In both cases our friends at the Bureau of Reclamation and at the Interior Department Office who, in my view, are the experts in determining the validity of these projects have intervened and apparently been able to change your mind or someone has.

I would like to believe that you truly understand the benefits that reclamation provide to this Nation. Can you explain to me what you believe these benefits are and what should the appropriate role of the Federal Government be?

Mr. STOCKMAN. Well, Senator, I think a lot of people come up here and doubletalk. So I will tell you what my personal opinion is. It is not the administration's, but I am always fingered as the one behind the scenes.

I am unsympathetic to reclamation. I will just tell you that.

Senator DECONCINI. Why is that, Mr. Stockman?

Mr. STOCKMAN. Because I do not think it makes sense to use the national taxpayers dollars to build reclamation projects that increase agricultural production when we are already sinking under huge surpluses and spending billions of dollars in income support for the farmers who cannot make a go of it in the marketplace, given the supply and prices that result.

Then I discover that under a long-standing procedure, the local reclamation district, or irrigation district does not have to pay back that Federal loan that it got to build the facilities for 50 years, and it does not have to pay any interest on the 50 year loan. I then conclude something is wrong.

It is not right to be giving 50-year, interest free money to local irrigation districts to bring land into production that is competing with the excess production capacity that we have all around the country today.

Now, we have not changed that. I am not saying we ought to repeal 50 years of history, however, I do understand the local perspective. It makes a big difference in parts of Arizona where I have been. I have seen all kinds of truck crop production and so forth on a desert that would not be there without irrigation.

However, I cannot see why we are taxing some guy who works in a steel plant or even taxing some farmer in Iowa, so that we can make 50-year, interest-free loans to local irrigation districts to add to production capacity we cannot use now.

That is why I am unsympathic. Maybe I am wrong in my understanding.

Senator DECONCINI. I appreciate that candidness. I really do because I think that is how you feel, and I think it is important that people know that and I respect it though I disagree with it.

Do you think it is proper for an Arizona taxpayer who works in the copper mine there or sells automobiles or practices law to pay money to build a deepwater port in Louisiana or in the Northeast part of this country?

Mr. STOCKMAN. No.

Senator DECONCINI. Do you apply the same philosophy?

Mr. STOCKMAN. Yes, sir, and that is why we have proposed 100 percent user fees as a way of recovering the cost from deepwater construction. I think it is just as unfair in your case as the one that I mentioned.

Senator DECONCINI. Because I find that very disturbing, Mr. Stockman, that this country has been a society that has invested geographically all over the country for the benefit of not only those in that particular area but for the entire country—the highway system, the water transportation system, the rural electric system.

And then what appears to me is that your philosophy has a lot of influence though you say you are not speaking for the administration, and I want the record to know that I understand that, that you think we ought to dismantle the rural electric, the highway system, the deepwater ports and irrigation systems, and that is very tragic, in my opinion, to see government come to that conclusion that no longer is it important to invest in America.

Last year this administration asked this Congress to appropriate $8.5 billion for the International Monetary Fund so it could be loaned out at 2 percent or no percent interest to foreign countries as they recycle their debts.

I did not hear you object to that, and I did not hear this administration object to it. It just is a real tragedy in my opinion, and I wish you would read for the record the little information I have on the benefit of reclamation.

I do not pretend that I can convert you, but I just hate to see a great Nation like this abandon the investment in this country that has made it so strong and yes, it is subsidy. No question about it when you build a deepwater port in Louisiana or Mississippi or New York or New Jersey.

But how better is it for this country to be able to ship our goods, to import goods that we need than to have that investment? And New York probably cannot afford to do it. Arizona, Los Angeles would not be the community it has today if it did not have water being provided to it from the Colorado River built by the Federal Government, now paid back because that is 40 years money which is over.

It is just very difficult. Phoenix would not be the community it has today if it was not that President Roosevelt authorized and pushed the Salt River project, building those dams. That money has been paid back. The taxes that are generated. I just wonder if you really thought it all out, and I only say that in the spirit of your candidness in telling me your views and I appreciate it for the record.

Mr. Chairman, I have other questions to be submitted for the record.

Senator ABDNOR. They will all be made a part of the record.

Since we are nearing the conclusion of this hearing, I, too, want to get parochial for a minute. No, it is not impact aid, Mr. Stockman.

Mr. STOCKMAN. We solved that one already. [Laughter.]

Senator ABDNOR. Well, not entirely but I guess we accept what we get. I want to talk along the same vein as Senator DeConcini has been talking with you. I have written you twice on a project of mine called the Belle Fourche irrigation project. It is anything but a new project. I guess it is probably the oldest in the Nation if not the second oldest. I think it is the oldest.

It is a small project but it has been an extremely valuable project for South Dakota. It is one of the few irrigation areas we have. In States like South Dakota where you have as many droughts as you have crops it has been a lifesaver to the people in that area to build or retain their herds to some degree.

It is not adding much crop to this. It is mostly feed that is raised there, and believe me it is consumed in that area. Well, we had funding for the fiscal year 1985 for the Belle Fourche irrigation project but you stipulated that these funds could only be used for preconstruction activities.

This authorized rehabilitation project is ready to begin construction activities right now, and I just wondered why OMB has designated that these 1985 funds can only be used for preconstruction.

Mr. STOCKMAN. Senator, I do not know the details of that project. I will have to submit it for the record.

Senator ABDNOR. I wish you would. It is very important to us.

Mr. STOCKMAN. My impression is that we would not like to see it go forward into construction, but maybe there is some other reason.

Senator ABDNOR. Well, you got a project there that has been a lifesaver up in that country. It is not something new. It has been in existence for a great many years and proven its net worth and finally has provided stability to the agricultural economy out in that northwest part of South Dakota.

Will you look at it?

Mr. STOCKMAN. Yes, I will.

Senator ABDNOR. I have driven a couple of times down there.

[The information follows:]

At the beginning of the fiscal year 1985 the Belle Fourche project had remaining $6.7 million of preconstruction planning and design work. OMB restricted the use of the $710,000 appropriated in 1985 for Belle Fourche to complete part of the preconstruction work as a logical step toward project implementation. However, the administration believes that any investment for total reconstruction of an existing project must be analyzed under present day conditions to determine if it is economically sound. Unfortunately, our analysis of Belle Fourche indicates that:

—The Belle Fourche project beneficiaries, despite several payment deferrals of some debt, have not been able to repay the cost of the existing project or past improvements;

—project economics are so poor that beneficiaries have not been able to maintain adequately the existing project;

—the present ability of project beneficiaries to repay construction costs is extremely low, about $5/acre;

—the proposed substanital additional investment will, at best, stabilize land values and won't result in enhanced repayment of project costs since any additional revenue generated by the investment will be needed to maintain the new features; and

—the expected return from the additional investment in Belle Fourche is too low to justify the proposed reconstruction.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. We have other questions for the record, and I think Senator Andrews has some questions also, as the chairman of the full committee, and Senator Hatfield, which we will submit to you in writing.

[The following questions were not asked at the hearing but were submitted to the Department for response subsequent to the hearing:]

Senator Abdnor. As I understand it, one of the purposes of the Paperwork Reduction Act is to reduce or eliminate unnecessary and costly forms and reports that various agencies require of taxpayers and industries. While I certainly subscribe to this objective, I'm told that there is at least one industry, the alcoholic beverage industry, the wine, beer and distilled producers, that not only do not object to being required to prepare and file monthly reports of their operations, but rely upon the statistical summaries that the government generates from those monthly reports, as the only reliable source of information that is so vital to their economic planning and decision making. In its deliberations, does OMB consider the benefits of records to the impacted industry. Did you do so in this instance?

Mr. Stockman. Our approval in January 1985 of an extension through September 1986 of the Bureau of Alcohol, Tobacco and Firearms (BATF) collection of monthly production reports collected from major segments of the alcoholic beverage industry indicates that we are sensitive to industry's use of information compiled from these reports. We extended our approval of the monthly collections to permit BATF to develop a more detailed justification of the need for this information for the proper performance of the agency's functions, and to complete and analyze the practical utility of these collections.

Members of the public will have an opportunity to comment on any changes that may be proposed in the next paperwork clearance of this information collection. In addition, any proposed changes in the frequency of collection would be published in the Federal Register as a Notice of Proposed Rulemaking with a comment period.

Senator Andrews. OMB, we understand, issued an Executive Order in January 1985 that broadened its role with regard to clearance and early review of regulations. What changes in the Department of Transportation (DOT) regulatory policy will this bring about? Will OMB be able to influence the regulatory process without such involvement being catalogued for the public docket?

Mr. Stockman. In the beginning of this Administration on February 17, 1981 President Reagan signed Executive Order No. 12291, "Federal Regulation." The purposes of that Order are to control the growth of Federal regulation and to ensure that individual regulations are well-reasoned, economically sound, and coordinated with the policies of other agencies. As required by the Order, new regulations must be based on adequate information concerning the need for and consequences of proposed action, and regulations must not be issued unless the potential benefits to society outweigh the potential costs to society. To ensure compliance with these principles, the President ordered that all proposed and final regulations be submitted for Office of Management and Budget (OMB) review before publication.

On January 4, 1985 President Reagan issued Executive Order No. 12498, "Regulatory Planning Process." This Order builds upon the principles and procedures of E.O. 12291. In effect, E.O. 12498 moves the OMB review conducted under E.O. 12291 to an earlier point in the agency's rulemaking process.

Under the new process, regulatory agencies are to submit to OMB, in January, a statement of the regulatory policies, goals, and objectives they intend to pursue during the coming year. They are also to provide a summary description of all significant regulatory actions -- prerulemaking as well as rulemaking activities -- underway or planned for the planning year (April 1 to March 31 of the following year).

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Senator Andrews. Has OST sought exemption from OMB's broadened regulatory review? If so, were exemptions granted or denied; in what areas and on what grounds?

Mr. Stockman. The Department of Transportation has not sought an exemption from compliance with E.O. 12498. Recently, DOT asked why OMB granted the Department of Justice an exemption from Supplement No. 1 to OMB Bulletin No. 85-9. We advised DOT that, after reviewing the rulemaking activities that the Department of Justice has planned for the upcoming year, we determined that Justice, unlike DOT, does not appear to have any significant regulatory actions of the sort that should be included in the Administration's Regulatory Program.

Senator Abdnor. I understand that OMB has approved the continuation of existing firearms records for the next 3 years. However, I am also aware that you are continuing to review Federal firearms recordkeeping requirements. How will you assure that valuable information used daily by state, local and federal law enforcement officials to solve murders, rapes, armed robberies, and assaults will not be adversely affected in any effort to reduce paperwork burdens upon Federal firearms licensees?

Mr. Stockman. Although the Firearms Transaction Record (Form 4473) and related reports appear to be useful for the purposes of

law enforcement, we are required by the Paperwork Reduction Act to ensure that these records do not impose an unnecessary burden on the public.

After our approval, we initiated a review of these records to obtain more complete documentation concerning the practical utility of the information collected and to determine whether less burdensome alternatives exist. In particular, BATF will consider whether: (1) information provided by Form 4473 for long guns, guns obtained from collectors and older guns contributes significantly to the resolution of crimes, and (2) different recordkeeping formats, including the consolidation of Form 4473 with the "bound book" dealer's inventory record (Form ATF 7570/20) would provide the necessary information with less burden on the public. Members of the public will have the opportunity to comment through notice and comment rulemaking as well as through the OMB paperwork review process on any changes that may be proposed to the Form 4473.

Senator Abdnor. In FY 1986 you propose to merge the Office of Federal Procurement Policy (OFPP) into OMB. Your statement indicated this merger will strengthen OFPP and enhance its stature by this integration. Could you outline how this will be accomplished?

Mr. Stockman. We are convinced that both the effectiveness and stature of the procurement policy function can be enhanced by making it a fully integrated element of OMB - with all the authority and visibility that identification provides. To some degree, the OFPP has operated as a semi-independent entity up to this point - not making full use of the OMB budget and management processes to further its goals of reforming the Federal procurement process. While it has been more effective in recent years, that effectiveness can be increased under our proposed merger.

Senator Proxmire. Mr. Stockman, you plan to merge the Office of Federal Procurement Policy into OMB. I understand that Senator Cohen and others on the Government Affairs Committee vigorously opposed this move. They feel that burying OFPP in OMB will diminish -- not enhance -- the role this office can and should play, particularly in reviewing Defense Department procurement policy. I tend to share their feelings in this regard. What are the reasons why you feel putting OFPP into the OMB structure will improve the Office's ability to tackle procurement problems in the Federal government, especially the Defense Department's procurement problems?

Mr. Stockman. Procurement is an important management tool but it does not exist in a vacuum. It is an integral part of the Federal management process - affecting, and being affected by, personnel policies, budget and accounting programs, supply

management procedures, and a host of other interrelated management functions used by the Government to conduct its business. By integrating the procurement policy function, organizationally, into the management program of OMB, we are assuring that full policy integration is achieved. Without such a merger, policy integration is often a "hit-or-miss" proposition - as a separate OFPP and separate OMB respond to priorities and agendas which are constantly changing and not easily coordinated.

As I mentioned in my response to Chairman Abdnor's question on this matter, the effectiveness and stature of the procurement policy function can be enhanced by making it a fully integrated element of OMB - with all the authority and visibility that identification provides. The ability of the procurement policy function to tackle Government-wide procurement problems, including those of the Department of Defense, can only be enhanced when full use is made of the OMB budget and management processes.

Mr. DeConcini. Mr. Stockman, as you know, last Thursday, the Senate passed by a vote of 97-0 a sense of the Senate resolution, stating that the full $1.5 billion should be apportioned to the States according to the intent of Congress. In light of this overwhelming vote by the Senate, what actions does OMB intend to take to release the remainder of the funds which have not been fully apportioned to the States to date?

Mr. Stockman. Let me emphasize that the Continuing Resolution appropriated $1.254 billion in part-year funding for WIC--not $1.5 billion, as the question might imply. Funding for the remainder of the year was made contingent upon a request by the Administration. Accordingly, the Administration sought and received a further $169 million with transmittal of the FY86 Budget, consistent with its policy to maintain the current WIC caseload of approximately three million persons.

The entire FY85 WIC appropriation of $1.423 billion has been fully apportioned consistent with the terms of the Continuing Resolution.

WIC funds have been allocated in keeping with the need to meet program requirements and continue responsible caseload management. I cannot comment further because the allocation of WIC funds is at present under litigation. We expect this issue to be resolved shortly.

Questions Submitted by Senator Dennis DeConcini

TAX SIMPLIFICATION AND MINIMUM CORPORATE TAX

Question.

Senator Deconcini. Can you clarify the Administration's posture on revenues -- a posture that on the one hand wails at the thought of anything that even smells like revenues, while at the same time, considering minimum corporate taxes and closing tax loopholes?

Answer.

Mr. Stockman. The current tax system is complicated and unfair. It slows economic growth and job creation, and hinders technological advancement by interfering with free markets and diverting productive investment into tax shelters and tax avoidance schemes. The President's tax reform proposals will reduce the complexity of the tax system and make it more fair. They are designed to foster economic growth by encouraging work, saving, and investment; rewarding risk - taking; and allowing resources to be allocated efficiently on the basis of economic rather than tax considerations.

While some individuals and corporations will pay higher taxes under the reform proposals than under current law, others will have their tax liability reduced. When taken together, however, the President's proposals will be "revenue neutral"; that is, when fully effective, they will raise virtually the same amount of revenue as under current law.

Although many current tax preferences will be eliminated under the reform proposals, some high income corporations will be able to reduce their tax liability substantially through heavy utilization of retained or expanded preferences. Since the prospect of high-income corporations paying little or no tax threatens public confidence in the system, an alternative minimum tax is being proposed.

Question.

Senator Deconcini. Can you tell the Committee what the five major legislative savings provisions the Administration wants to see come out of reconciliation? Is it Federal retirement? User fees?

Answer.

The Administration supports the reconciliation targets contained in the Resolution, as passed by the Senate, as an important step toward achieving permanent reductions in the level of Federal spending commitments. In our view, no one provision -- or set of five provisions -- is more or less important than any other.

Question.

Senator Deconcini. What steps is the Administration prepared to take if the reconciliation package that comes back to the Senate in June does not contain the mix of savings that it wants for the various Committees?

Answer.

Mr. Stockman. The Administration endorsed the reconciliation savings recommended in the First Budget Resolution for Fiscal Year 1986 passed by the Senate and will work with the designated committees to achieve these savings. Since the committees have not reported any savings, it would be premature to speculate about alternative courses of action to be taken by the Administration in the event that these savings are not achieved in the reconciliation package that comes to the Senate floor in June.

QUESTIONS SUBMITTED BY SENATOR WILLIAM PROXMIRE

Senator Proxmire: Mr. Stockman, to what degree does OMB work with the Inspector General of the various Departments and agencies to make certain that the waste and fraud found by the auditors ends quickly and completely?

Mr. Stockman: The Office of Management and Budget works with the Inspectors General through a number of formal and informal processes to eliminate wasteful practices and to ensure that Inspector General recommendations are promptly resolved.

First, the Congress requires agencies to report every six months on any audit recommendations which are not resolved within a six month period after their issuance. OMB closely monitors agency resolution of Inspector General recommendations and the entire audit follow-up process. In fact, one of the first priorities the Administration faced upon coming to office was a backlog of nearly 2,500 audit reports valued at over $1.6 billion. In the past four years, working with agency management and the Inspectors General, OMB has helped reduce this total to approximately 225 reports valued at about $141 million in civilian agencies. This reduction is especially impressive in the face of ever increasing efforts by the Inspectors General to uncover fraud and mismanagement.

As part of the Administration's emphasis on implementing Inspector General recommendations, the President designated senior agency officials and made one individual in each agency responsible for audit follow-up. This action and the development of a close working relationship between agency management, the Inspectors General, and OMB has established a sound and effective process of audit-follow.

In addition to the formal audit follow-up process, OMB for the first time last fall began to review departmental Inspector General audit reports and audit recommendations for inclusion in OMB's budget process. OMB review of Inspector General recommendations had occurred sporadically before, but OMB had never undertaken a systematic review of departmental Inspector General recommendations for a budgetary impact. The issues and Inspector General audit findings uncovered in this review proved valuable in a number of ways. Some of the issues had budgetary implications and were used by OMB to develop possible agency cost savings recommendations. Others were focused more on management improvement and were used to develop background and questions for agency hearings and examinations to ensure that agency management implemented the recommendations quickly. We believe that OMB's review of IG recommendations in this informal way has provided an additional "audit follow-up" mechanism to ensure agency compliance with Inspector General audit recommendations.

As part of the FY 1987 Management Review process, the Inspectors General were also surveyed and asked to provide any information and suggestions on agency-specific and/or government-wide areas for OMB review.

QUESTIONS SUBMITTED BY SENATOR MARK ANDREWS

Senator Andrews. The fiscal year 1985 appropriation for "Interstate Commission salaries and expenses" (as contained in P.L. 98-473) was $48 million. The Office of Management and Budget (OMB) apportionment granted the Commission first quarter spending authority for the entire sum. Why did OMB grant this category of apportionment?

Mr. Stockman. On November 2, 1984, the Commission requested a category B apportionment in order to provide management with the needed flexibility to make quick changes in allocating its resources. As examples, the Commission cited that a category B apportionment would allow the Commission to conduct reductions-in-force, incurring the attendent expenses earlier in the year than a category A apportionment would allow. The Commission also stated that termination of certain contracts could be considered if funds were available early in the year to pay anticipated termination costs.

Senator Andrews. The Commission's rate of spending in the first quarter has necessitated a supplemental appropriation request, as

well as employee furloughs. In what way did OMB let the Interstate Commerce Commission (ICC) know it had to curtail spending to live within its appropriation?

Mr. Stockman. OMB made it clear to the ICC that it was expected to live within its appropriation and not violate the Antideficiency Act. More specifically, OMB staff orally made the Commission aware that although a supplemental appropriation was being requested by the Administration and management flexibility was being provided through the apportionment process, the ICC was in no way exempt from the requirements of the law regarding spending more funds than had actually been appropriated for a given fiscal year.

Senator Andrews. When did OMB know the ICC would have to furlough employees to stay within the current law funding level of $48 million?

Mr. Stockman. On November 2, 1984, the ICC simultaneously submitted a request for supplemental 1985 funding to OMB and the House and Senate Appropriations Committees. This request stated,

> "Because of the long lead time required to effect reductions in force and the extremely high costs of terminal leave, severance, and unemployment compensation payments associated with separating a highly tenured workforce, savings in personnel compensation cannot be quickly achieved. As a result, if supplemental funding is not approved, the Commission will be forced to reduce through involuntary separation to a level below 700 positions and to furlough employees."

Senator Andrews. Did the ICC consult with OMB as to the best alternative(s) for staying within the $48 million funding level (pending supplemental approval)?

Mr. Stockman. No.

Senator Andrews. Given the Administration's proposals for cuts in other agencies, why did OMB find that the ICC should not be asked to cut its total budget for fiscal year 1985 below the original request for 1985 (original request $53,966,000; total request in the supplemental $53,463,000)?

Mr. Stockman. The original request for 1985 was $4.8 million below the 1984 appropriation, or a reduction of 8%. Congress cut the ICC's 1985 budget further, equating to an 18% cut from 1984. Even with the proposed supplemental, the 1985 ICC budget would represent a reduction of 9% from 1984 levels and includes $1 million for statutorily mandated pay increases. Since passage of deregulation legislation reducing the responsibilities of the ICC, this Administration has strongly supported well planned, justified reductions in Commission staffing and funding levels. Since 1981, funding for the Commission has been reduced from $82.4 million to our 1985 request level of $53.4 million, or by 35%. Staff years have been reduced from 1,836 to a requested 949, or by 48% since 1981.

Senator Andrews. Why is it necessary for ICC Commissioners and their staffs to average 600 square feet per employee when the General Accounting Office (GAO) guidelines for footage recommends 135 square feet per employee?

Mr. Stockman. The General Services Administration (GSA) has issued two regulations, FPMR Temp. Reg. D-68, Assignment and Utilization of Space, and FPMR Temp. Reg. D-70, Work Space Management Reform, providing guidelines for utilization of federal workspace. According to D-68, the goal for agencies is

to achieve "...135 square feet per person or a minimum improvement of 10 percent in each agency's utilization rate compared with the utilization rate which exists as of the date of issuance of this regulation." OMB's understanding of the intent of the GSA regulations is that they set an overall agency-wide space allocation average, rather than specifying that each agency employee must be allocated no more or less than 135 square feet of office space. That is, an agency with 1,000 employees should have no more than a total of 135,000 square feet of office space, regardless of how that space is allocated on a per person basis. The ICC headquarters averages 226 square feet of office space per employee. This is higher than the GSA recommended average because the ICC occupies a historic building in which it is quite difficult and expensive to alter the space by moving walls, etc. D-68 further states that space reductions "...should be accomplished with minimum space alterations and within existing agency resource constraints."

Senator Andrews. What recommendations has OMB made to GAO to reduce [ICC] funding requirements in light of declining responsibility under deregulation legislation?

Mr. Stockman. OMB has not, to date, been asked for any such recommendations by GAO, nor has OMB provided such information to GAO on its own initiative.

Senator Andrews. Has OMB done a study or made recommendations regarding the ICC's contracting out some of its functions? Which ones? What is the estimate of savings to be realized by contracting out?

Mr. Stockman. As part of a government-wide initiative, OMB requested that the ICC study whether it could contract out the functions of its in-house printing plant. The ICC found that savings could be achieved by turning the printing function over to the Government Printing Office (GPO). Savings are estimated at $500,000/year.

Senator Andrews. On what grounds can an agency request a category "B" apportionment?

Mr. Stockman. There are two categories of apportionment -- category A and category B. Category A apportionments are apportionments where the agency has requested and OMB has approved a distribution of amounts by quarter. Category B apportionments are any other apportionments. For example, in a category B apportionment, amounts could be distributed by:

-- time periods other than quarters;

-- projects;

-- objects; or

-- a combination of the above.

OMB regulations grant agencies the discretion to request either category A or B apportionments.

Senator Andrews. Must all spending above the normal quarterly allowance be only in accordance with the basis cited in the category "B" request?

Mr. Stockman. There are no legal restrictions based on an agency request for a category "B" apportionment. As a general rule, only the total amount of the appropriation and apportionment approved by OMB are binding.

Senator Andrews. If OMB approves accelerated spending, what responsibilities does the affected agency and OMB have if Congress does not approve the supplemental?

Mr. Stockman. In accordance with the Antideficiency Act, agencies have the responsibility to stay within the amount appropriated. OMB's approval of an apportionment does not authorize agencies to exceed available resources. Under OMB regulations, the agency has the responsibility to plan for the possibility that the supplemental will not be approved and obligate funds accordingly.

Senator Andrews. What tools or recourse does OMB or Congress have to stop over-spending if it is not found to be prudent?

Mr. Stockman. Aside from the apportionment process mentioned earlier, the tools that the President and OMB have to stop overspending (i.e., appropriations in excess of amounts requested) are limited. In accordance with the Impoundment Control Act, the President can: 1) defer funds for a portion of the year in order to restrain the rate of spending; or 2) propose a rescission and report these actions to the Congress. However, the deferral remains in effect only if both Houses of Congress do not overturn it. In the case of a rescission proposal, amounts are made available for obligation if Congress does not enact the rescission within the prescribed 45-day period. Congress can also act to defer or rescind funds on its own initiative.

Senator Andrews. If an agency spends at an accelerated rate and OMB has not provided a deficiency apportionment, what is the responsibility of the agency to stay within the fiscal year appropriation?

Mr. Stockman. As I stated in response to question 11, agencies have the responsibility to stay within the limits of the amounts available in the appropriation or fund. Any overobligation or overexpenditure of an appropriation or fund by an agency is a violation of the Antideficiency Act by that agency.

Senator Andrews. What penalties does an agency head face if the fiscal year spending is above the rate allowed by current law, and OMB has not approved the spending through a deficiency apportionment?

Mr. Stockman. The amount appropriated for the ICC in 1985 was a lump sum ($48 million). No Antideficiency Act violation would occur unless there is an overobligation or overexpenditure of the amounts available in the appropriation or fund or of the apportionment current at the time the overobligation or overexpenditure occurs. If any such violation occurs, the head of the agency is required to report to the President and the Congress. The person responsible for the violation is subject to appropriate administrative discipline, including, when circumstances warrant, suspension from duty without pay or removal from office. Criminal penalties may also apply if the individual responsible knowingly or willfully violated the Antideficiency Act.

Senator Andrews. Please cite those characteristics which OMB felt were unique to the ICC, such that the Congress could not reduce the agency's funding below that originally approved by OMB.

Mr. Stockman. Congress <u>can</u> reduce the agency's funding below that approved by the President, as evidenced by the Congress's actions to date. We do not dispute that congressional prerogative. The ICC has taken action to live within its appropriation. On the other hand, the Administration determined

that the amount of the reduction in funding enacted by Congress would not allow the ICC to continue to reduce its size and simultaneously to carry out its statutory responsibilities in a reasonable, orderly manner. Therefore, the Administration has requested a supplemental for the ICC.

Senator Andrews. Please list the dates for the following:

- o ICC request for category "B" apportionment;
- o OMB approval of the category "B" request;
- o ICC request for a fiscal year 1985 supplemental;
- o OMB approval of the supplemental;
- o OMB notification to the ICC of the supplemental approval.

Mr. Stockman. The dates are as follows:

- o November 2, 1984
- o November 9, 1984
- o November 2, 1984
- o December 17, 1984
- o December 19, 1984

Senator Andrews. OMB, we understand, issued an Executive Order in January 1985 that broadened its role with regard to clearance and early review of regulations. What changes in the Department of Transportation (DOT) regulatory policy will this bring about? Will OMB be able to influence the regulatory process without such involvement being catalogued for the public docket?

Mr. Stockman. In the beginning of this Administration on February 17, 1981 President Reagan signed Executive Order No. 12291, "Federal Regulation." The purposes of that Order are to control the growth of Federal regulation and to ensure that individual regulations are well-reasoned, economically sound, and coordinated with the policies of other agencies. As required by the Order, new regulations must be based on adequate information concerning the need for and consequences of proposed action, and regulations must not be issued unless the potential benefits to society outweigh the potential costs to society. To ensure compliance with these principles, the President ordered that all proposed and final regulations be submitted for Office of Management and Budget (OMB) review before publication.

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Senator Andrews. Will low-level career employees of OMB be able to overrule DOT policy officials on regulatory matters?

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Senator Andrews. Has OST sought exemption from OMB's broadened regulatory review? If so, were exemptions granted or denied; in what areas and on what grounds?

Mr. Stockman. The Department of Transportation has not sought an exemption from compliance with E.O. 12498. Recently, DOT asked why OMB granted the Department of Justice an exemption from Supplement No. 1 to OMB Bulletin No. 85-9. We advised DOT that, after reviewing the rulemaking activities that the Department of Justice has planned for the upcoming year, we determined that Justice, unlike DOT, does not appear to have any significant regulatory actions of the sort that should be included in the Administration's Regulatory Program.

SUBCOMMITTEE RECESS

Senator ABDNOR. With that, we will conclude our hearing for today. I want you to know we appreciated our opportunity to discuss some of these problems with you. I thought it was a real good session. It was held in the right spirit. We have no further business.

With that, we will be in recess until Tuesday, May 21 at 10 a.m., when we will conclude the 1986 budget hearings with testimony from the Secretary of the Treasury, the Honorable James Baker.

[Whereupon, at 3:50 p.m., Monday, May 13, the subcommittee was recessed, to reconvene at 10 a.m., Tuesday, May 21.]

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 1986

TUESDAY, MAY 21, 1985

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10 a.m., in room S-126, the Capitol, Hon. James Abdnor (chairman) presiding.

Present: Senators Abdnor, Mattingly, DeConcini, and Proxmire.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF JAMES A. BAKER III, SECRETARY OF THE TREASURY

ACCOMPANIED BY JOHN F.W. ROGERS, ASSISTANT SECRETARY OF THE TREASURY FOR MANAGEMENT

OPENING REMARKS

Senator ABDNOR. I will start the committee meeting with a full apology for keeping you waiting, Mr. Secretary.

This morning, we are going to hear from the Secretary of the Treasury, the Honorable James A. Baker III. This is the Secretary's first appearance before the subcommittee since assuming his position in January.

So, Mr. Secretary, I do want to offer you a very warm welcome, and I am sure I do so on behalf of Senator DeConcini. Oh, there is Senator Mattingly.

Senator MATTINGLY. Yes; I was here first. [Laughter.]

Senator ABDNOR. I do want you to know that even though this is his first appearance, it is not our initial contact. Really, all you did is you may have changed hats from the time you were at the White House and now over at the Treasury.

We have worked together at various times during the 4 years and I am sure that the good working relationship we have cultivated will continue during your time at the Department.

And we welcome you to the committee, too, Mr. Rogers.

So, Senator DeConcini, do you have an opening statement?

Senator DECONCINI. I have no opening statement except to welcome the Secretary.

Senator ABDNOR. Senator Mattingly?

Senator MATTINGLY. I do not have anything, Mr. Chairman.

Senator ABDNOR. Mr. Secretary, why do you not just proceed any way you want to here?

Secretary BAKER. Thank you, Mr. Chairman. I am pleased to be appearing before this subcommittee for the first time to discuss the operating budget for the Department for fiscal year 1986.

PREPARED STATEMENT

With your permission, I have an expanded statement which I will submit for the record and I will, if it is all right, briefly summarize that statement.

Senator ABDNOR. Please do. Without objection, your entire statement will be made a part of the record.

[The statement follows:]

STATEMENT OF JAMES A. BAKER, III

I am pleased to appear before this Subcommittee for the first time to discuss the operating budget for the Treasury Department for Fiscal Year 1986.

As this Subcommittee is well aware, and as I have come to understand better during the past several weeks, the Treasury Department carries out functions that are truly essential to the existence of our Federal system of government. We administer the Nation's tax system, and collect the government's revenues. We manage the government's fiscal affairs, including paying its bills and financing the nation's public debt. We manufacture the currency and coin that are essential to the nation's commerce and economic well-being. We help regulate our country's financial institutions. We process passengers and cargo coming into the country, enforcing import and export laws. We carry out basic federal law enforcement responsibilities, including protecting the President, Vice-President, as well as other dignitaries. We participate in the effort to combat illegal drug smuggling, and administer firearms and explosives laws. Finally, we advise the President on monetary, economic, and tax policies.

To continue to carry out the functions of the Treasury Department in Fiscal Year 1986, we are requesting a total budget of $5.3 billion and 121,006 positions. These funding and staffing totals include $6 million and 75 positions for the administration of the revenue sharing program; that request is reviewed by the Appropriations Subcommittee for Housing and Urban Development and Independent Agencies.

Our budget request for FY 1986 represents a decrease of $45 million, or 0.8%, below the comparable Fiscal Year 1985 levels.

In addition to these funding and staffing requests for the operations of the Treasury Department, our Fiscal Year 1986 budget reflects a proposed transfer of certain responsibilities of the Small Business Administration to the Treasury Department. Our budget includes $74 million and 1,650 positions for the administrative costs of servicing existing direct loans and monitoring the servicing of guaranteed loans. The budget also includes $2.6 billion for expenses directly associated with the portfolio, including writing off defaulted loans. Our understanding is that this request concerning the transfer of the Small Business Administration will not be taken up by the Treasury Appropriations Subcommittee, but will be covered by the Commerce, Justice, State and Judiciary Subcommittee.

The Fiscal Year 1986 budget for the Treasury Department has several major objectives. First, the overall budget request reflects our participation in the governmentwide 1-year freeze in total spending other than debt service. Specifically, we have maintained spending levels appropriated in the Fiscal Year 1985 Continuing Resolution plus critical supplemental requests.

Second, our budget reflects two specific governmentwide proposals included in the President's budget -- a reduction of 5% in Federal civilian pay effective January, 1986, and a 10% reduction in administrative and overhead costs.

The 5% pay reduction will produce savings of approximately $135 million in the Treasury Department's budget for Fiscal Year 1986.

To accomplish the 10% reduction in administrative costs, we will streamline administrative and support operations. Every Treasury organization will participate in this effort; the estimated savings in Fiscal Year 1986 is $64 million. The

majority of these savings will be accomplished in the Internal Revenue Service and the U.S. Customs Service. The IRS reduction reflects cuts in personnel, printing, and general support operations. The reduction in the U.S. Customs Service reflects the centralization of administrative functions, certain organizational realignments, and various operational and management efficiencies.

Strengthening law enforcement capabilities is a third objective of this budget.

We will increase our participation in the President's Organized Crime Drug Enforcement Task Forces. We are requesting supplemental funding of $6.5 million in Fiscal Year 1985 to support Treasury's participation in the 13th City Task Force in Miami. These Task Forces have achieved dramatic results. Since October of 1982, the Task Forces have initiated over 800 cases, which have resulted in over 4,300 indictments and more than 1,600 convictions. Over two-thirds of these cases have been the direct result of financial investigations. These efforts have focused on the criminal leadership in this country; this has resulted in the breakup of many formerly well-financed and tightly-controlled organized crime operations.

We are moving to strengthen our drug interdiction efforts. We will acquire three additional P-3A aircraft this summer for surveillance. We have recently completed the installation of a third air-to-air surveillance aerostat in the Bahamas. Further, we will acquire eight new, high endurance, tracking aircraft this year with funds appropriated in FY 1984.

Our Fiscal Year 1986 budget for air interdiction represents an increase of $16 million, or 36%. These funds will be used to operate the P-3A aircraft to be acquired this summer, to install radars and night vision devices in certain interception aircraft,

to operate up to two additional helicopters, and to begin developmental work on a 360 degree search radar system.

The Treasury Department is most appreciative of the assistance we have received from the Defense Department over the past several years in our efforts to stem the flow of illegal drugs into the country. As I am sure you are all aware, the drug traffic from Central and South America, through the Caribbean, is an increasingly serious problem. Treasury must do everything that we can to work together with all Federal agencies who can aid in this war on drugs. To this end, I am asking the Assistant Secretary of the Treasury for Enforcement and Operations to meet with the Defense Department to develop a joint plan for strengthening our anti-smuggling capabilities in the Caribbean Basin.

Our budget contains a proposed Fiscal Year 1985 supplemental of $4.1 million to provide security and related equipment for the perimeter of the White House, Naval Observatory, and Main Treasury. We believe that these improvements are critical due to the recent events world-wide and the increased threat of terrorist activity in this country.

In order to provide improved handling of seized property, we are requesting $6 million in Fiscal Year 1985 and $8 million in Fiscal Year 1986 for a new Customs Forfeiture Fund. This Fund was authorized by Congress last year in both the Trade and Tariff Act of 1984 and the FY 1985 Continuing Resolution. The Fund operates using the net proceeds from the disposition of seized and forfeited merchandise and currency. We will use the Fund primarily to pay for expenses related to seizures and to equip forfeited vessels, vehicles, and aircraft for use in narcotics interdiction. We believe that this Fund not only will enable us to increase significantly the profits from the sale of seized

assets, but also will increase the equipment available to us for drug interdiction.

A fourth major objective of this budget is to continue major efforts to modernize Treasury systems and equipment. Even within an overall spending freeze, we cannot postpone the introduction of new technology and modern equipment. These investments are essential to the Department's ability to handle growing workloads and to relieve future pressures for growth in personnel.

To help modernize the tax administration system, our budget includes resources to continue two major projects now under development -- the Automated Examination System and the Tax System Redesign Project. The Automated Examination System will equip IRS enforcement personnel with modern equipment to help them in the auditing of tax returns. When this system is fully implemented, productivity is expected to increase by as much as 25%. The Tax System Redesign Project is a longer-term effort to enable IRS to create an overall modernized system that will meet the requirements of the 1990's.

The U.S. Customs Service is seeking an additional $14 million to automate its major commercial processing procedures, to develop an integrated data telecommunications network, to replace the current 15 year old Treasury Enforcement Communications System, and to apply new technology to drug interdiction efforts. Customs' Automated Commercial System will involve automated processing of entries from the trade community, eliminate redundancies, reduce paper, and enhance selectivity procedures in the cargo review process.

The Department's fiscal bureaus will continue to improve the government's financial systems, the means by which we collect, manage, and disburse federal funds and finance the public debt. The Financial Management Service is requesting an additional $14

million to complete replacement of the Service's headquarters computer, continue efforts to upgrade the government's collection and payment systems, and enhance the financial telecommunications network. The Bureau of the Public Debt is requesting $3.5 million for funding for the first phase of a project to replace the Bureau's mainframe computer and to purchase new equipment for the processing of Savings Bonds issue stubs.

A fifth major objective of this budget is to strengthen the tax administration system to collect additional revenues that are owed by taxpayers. Beginning in FY 1987, we will add 2,500 positions for Examinations in each of three fiscal years, for a total of 7,500 positions. This initiative will produce an estimated $4.6 billion in additional revenue during Fiscal Years 1987-1989. This proposal is recommended by the President's Private Sector Survey on Cost Control, and involves the collection of taxes that are legitimately owed. It is only equitable that we not ask the vast majority of American taxpayers, who pay their fair share of taxes, to have to subsidize those who do not contribute. To implement this initiative, we will conduct some advance hiring at the end of Fiscal Year 1986.

Our budget also provides, within existing resource levels, for implementation of certain provisions of the Deficit Reduction Act of 1984. Specifically, we will enforce the new tax shelter registration requirements, as well as provisions which will provide additional information to IRS. The tax shelter requirements are especially important as they will provide IRS with the ability to identify and target abusive shelters for enforcement action.

A sixth major objective of this budget is to accomplish productivity savings through improved management and automated

systems. Specifically, our budget identifies savings of $23 million and 748 positions. The majority of these savings will result from efficiencies in the processing of tax returns and automation of the collection field function.

In addition to the major objectives that we have identified, our budget anticipates a large and growing workload. Some examples include:

-- IRS will process 178.7 million tax returns, an increase of 3% above the previous year.

-- We expect to audit or contact over 2.7 million taxpayers, close an estimated 3.3 million delinquent tax accounts, and provide some form of assistance to over 55 million taxpayers.

-- We anticipate that 311 million passengers will arrive at U.S. borders; this represents a growth of 4.3%. We will process 7.1 million formal entries of merchandise -- 6% more than in FY 1985.

-- Treasury will issue over 80 million savings-type securities and redeem more than 82 million. We will make over 731 million payments, an increase of 2% above the prior year.

-- We will print 6.6 billion pieces of currency, an increase of 6.5%, and 35.8 billion postage stamps, an increase of 3%. We will manufacture approximately 16.2 billion coins.

In summary, in terms of the major overall changes to the budget, we are seeking:

-- $67.1 million for program enhancements, related primarily to the objectives that I have described;

-- $14.6 million for increased workload, especially in the area of tax administration;

-- $262.4 million for price increases in such areas as communications, office space, travel, and utilities; and

-- an offset of $387.3 million in program reductions. These include the 5% pay cut, the 10% savings in administrative areas, and various productivity and one-time savings throughout the Department.

FISCAL YEAR 1985 PROPOSALS

Our budget contains supplementals totalling $77.1 million and rescissions totalling $9.5 million for Fiscal Year 1985. The supplemental requests include $44.9 million to cover 50% of the pay increase effective this past January and program supplementals of $32.2 million.

The program supplementals include funds to cover the recent postage rate increase for the Financial Management Service; to establish the 13th Organized Crime Drug Enforcement Task Force in Miami; to make certain security improvements to the White House, Naval Observatory, and Main Treasury; to provide a one-time capitalization increase to the IRS' Tax Lien Revolving Fund; to support the Customs Seizure Fund; and to establish User Fees at Certain Small Airports.

The proposed rescissions of $9.5 million are in response to Section 2901 of the Deficit Reduction Act of 1985. That Section requires executive branch agencies to achieve savings in costs associated with motor vehicles, travel, consulting services, printing, and public affairs.

Mr. Chairman, that summarizes the major proposals of the Treasury Department. I shall be happy to answer any questions that the Subcommittee may have.

REDUCING EXCESSIVE FEDERAL SPENDING

Secretary BAKER. This budget, Mr. Chairman, recognizes the need to reduce the excessive rate of Federal spending while upholding the policy role the Treasury Department plans in the fiscal arena. First, we must place the Federal budget deficit on a declining path and keep it there.

Second, we are committed to a thorough revision of the tax system to insure that it is fair, simple, and that it encourages economic growth. Finally, we will continue to enhance the strength and stability of the international monetary system.

With respect to our management responsibilities, the Treasury Department carries out functions essential to the existence of our Federal system of Government. We administer the Nation's tax system and collect the Government's revenues.

We manage the Government's fiscal affairs, including paying its bills and financing the public debt. We manufacture the Nation's currency and coin. We help regulate our country's financial institutions.

We process passengers and cargo coming into the country, enforcing import and export laws. We carry out basic Federal law enforcement responsibilities, including protecting the President and Vice President, as well as other dignitaries.

We participate in the effort to combat illegal drug smuggling and administer firearms and explosives laws. Finally, we advice the President on monetary, economic, and tax policies.

To continue to carry out the functions of the Treasury Department in fiscal year 1986, we are requesting a total budget of $5.3 billion and 121,006 positions. Our budget request for fiscal 1986 represents a decrease of $45 million, or eight-tenths of 1 percent below the comparable fiscal year 1985 levels.

FISCAL YEAR 1986 OBJECTIVES

The fiscal year 1986 budget for the Treasury Department has several major objectives. First, the overall budget request reflects participation in the Governmentwide 1-year freeze in total spending other than debt service. Specifically, we have maintained spending levels appropriated in the fiscal year 1985 continuing resolution, plus critical supplemental requests.

Second, our budget reflects two specific Governmentwide proposals included in the President's budget—a reduction of 5 percent in Federal civilian pay effective January 1986, and a 10-percent reduction in administrative and overhead costs.

Strengthening law enforcement capabilities is our third objective. We will increase our participation in the President's organized crime and drug enforcement task forces through supplemental funding for the 13th city task force in Miami.

We are moving to strengthen our drug interdiction efforts. Our fiscal year 1986 budget for air interdiction represents an increase of $16 million, or 36 percent over the 1985 level.

The budget also contains a proposed fiscal year 1985 supplemental of $4.1 million to provide security and related equipment for the perimeter of the White House, the Naval Observatory, and Treasury Department.

Finally, to improve the handling of seized property, we are requesting $6 million in fiscal year 1985 and $8 million in fiscal year 1986 for a new customs forfeiture fund, as authorized by Congress.

The fourth major objective is to continue major efforts to modernize Treasury systems and equipment. Even within an overall spending freeze, we cannot postpone the introduction of new technology and modern equipment. These investments are essential to the Department's ability to handle growing workloads and to relieve future pressures for growth in personnel.

The fifth major objective is to strengthen the tax administration system to increase the collection of revenues owed by taxpayers. Beginning in fiscal 1987, we will add 2,500 positions for examinations in each of the 3 fiscal years, for a total of 7,500 new positions. This initiative will produce an estimated $4.6 billion in additional revenues during fiscal years 1987, 1988, and 1989, at a total cost of $530 million.

This proposal is recommended by the President's private sector survey on cost control and it involves the collection of taxes that are legitimately owed.

A sixth major objective is to accomplish productivity savings through management and automated systems. Specifically, our budget identifies savings of $23 million and 748 positions.

In addition to the major objectives we have identified, our budget anticipates a large and growing workload. For example, we will process 3 percent more tax returns and 6 percent more formal entries of merchandise. We expect to print 6.5 percent more pieces of currency.

SUMMARY OF REQUEST

In summary, in terms of the major overall changes to the budget, we are seeking $67.1 million for program enhancements related primarily to the objectives I have described; $14.6 million for increased workload, especially in the area of tax administration; $262.4 million for price increases in such areas as communications, office space, travel, and utilities; and an offset of $387.3 million in program reductions. These include the 5-percent pay cut, the 10-percent savings in administrative areas, and various productivity and one-time savings throughout the Department.

Mr. Chairman, that summarizes the major proposals of the Treasury Department and I will be happy to answer such questions as the subcommittee might have.

Senator ABDNOR. Thank you, Mr. Secretary.

Before we go on, I now know John's title. John Rogers is Assistant Secretary for Administration, and we certainly all look forward to working with you.

Mr. ROGERS. Thank you, Mr. Chairman.

Senator ABDNOR. You, too, are wearing a different hat. We know the Secretary needs you badly and we are happy you are over there.

THE 5-PERCENT SALARY REDUCTION

While you were talking, you said that includes the 5-percent cut. Now, it looks like that is going to be restored. If it is, I assume you will find adequate places for those dollars. If the payroll is not cut, I suppose it will be used that way. Is that the idea, or how will you handle that?

Secretary BAKER. Well, I cannot tell you this morning, Mr. Chairman, how we would handle the restoration of those funds.

Senator ABDNOR. You would have some latitude, I am sure.

Secretary BAKER. Obviously, and we would be glad to work with the subcommittee in that regard.

Senator ABDNOR. Well, it will make some difference in your budget and additional people may be needed.

You are probably aware that this subcommittee has taken a strong stand in law enforcement. I am sure that has been brought to your attention. As a matter of fact, in the past few years, we have had our differences with the administration, over the budget request for the bureaus in the Department.

CUSTOMS—PERSONNEL REDUCTIONS

Once again, we are faced with a request for a reduction in personnel in the Customs Service, Secret Service, and also the Bureau of Alcohol, Tobacco and Firearms. I know economies are being made, but I have real problems with the more for less atmosphere that we are creating with regard to law enforcement.

Do you really believe that customs will be able to do a better job with nearly 900 fewer people, and is it not about time to come to grips with the fact that they have a difficult job to do and it takes people to do that job?

Secretary BAKER. Well, I certainly agree with you, Mr. Chairman, that they have a difficult job to do and it takes an adequate number of people to do that job.

But by the same token, we feel that there are a number of vestigal and, if you will, outmoded positions that we can do without and still do as effective a job of law enforcement.

What we are talking about is eliminating certain administrative functions which have grown up through the years. We are not talking about reducing front-line enforcement capabilities. And I do not think that this proposal is going to jeopardize the law enforcement capabilities of the Bureau or of the Department.

And let me add, having said that, as I have testified before the House, I am a strong supporter of law enforcement. I have committed, during the course of my confirmation hearings, to take a personal interest in those elements of the Department, and so far I believe I have lived up to that commitment. I think the directors of the law enforcement bureaus in the Department would agree with that.

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We are certainly not seeking to do anything that would minimize the effectiveness of the law enforcement capabilities of the Department.

Senator ABDNOR. Well, now, do not get us wrong. We are not trying to block efficiencies in the administration, but I think our understanding is that all those 900 people—there are going to be some front-line people, unless you can show us otherwise. That is where we would have a hard time drawing the line.

I, too, know you have been strong in law enforcement, but over the last couple of years—one time they wanted to take 2,000; we did not go along with it. The next time, we talked about 800 or 900. As a matter of fact, I think we had our staff over checking the administration one time when we were trying to see if we could not help in every way we could.

If you use some different equipment that will do the job with less manpower, fine. But I think the House Budget Committee has restored something like 800 jobs over there and I think they are adding 1,000 in the IRS.

UNDERGROUND ECONOMY

Now, let me ask you something. We hear about this $90 billion of IRS that goes unreported. Do you think this is a place where more manpower would bring in more dollars?

Secretary BAKER. I think the best way to get at the underground economy, Mr. Chairman, would be to reform the Tax Code. And, of course, as you know, that is one of the President's major domestic priorities.

I think to the extent we build respect for the code, we will build respect for Government generally and I think more people will be willing to declare their income and pay taxes on it.

The additional staff that we are suggesting for the Internal Revenue Service beginning in fiscal 1987—2,500 agents per year—as my statement indicated, is primarily to collect taxes owed.

Senator ABDNOR. Well, I would be inclined to agree. I think the simpler we make the Tax Code, the less manpower it takes to follow through on the returns.

But the Customs and these others—you would agree with us, then, that if we were to take them off the front line, that would be a mistake?

Secretary BAKER. Yes, sir; and I would go further, Mr. Chairman, and say that if it is the judgment of the Congress in the discharge of your constitutional responsibilities that you are going to restore positions that we have asked be eliminated—while we cannot agree with that, and do not, I would urge you to look very, very carefully at the method of doing that so that you make sure that the restorations are in front-line enforcement responsibilities.

Senator ABDNOR. We have no quarrel with that.

Senator DeConcini?

Senator DECONCINI. Mr. Chairman, thank you.

Just to follow up on that line, Mr. Secretary, if we do restore the 800 or so positions that have been cut, you have just told us that you would put them on the front line. So, do we need to tell you to do that? We can do it, but I believe you are a man of your word and if we elected to do that, even though you had not asked for it, I presume the 887 positions would go on the front line.

Secretary BAKER. Well, that is where they would go, but we would want to see the restoration accomplished, Senator, in a way that would permit us to eliminate those administrative positions we are seeking to cut so that those slots could be moved to front-line positions.

AIR WING ESTABLISHMENT

Senator DECONCINI. That is fair enough. It just appears to me that with some of the things that are coming on board in the Air Interdiction Program—and your budget has accounted for much of that—there may be even more coming on if my amendment to establish an air wing passes on this bill. The House bill already has it in it. There may be some need there.

I wonder if any thought or plan had been given to that potential air wing being established.

Secretary BAKER. Senator, we are generally supportive of the concept, as I hope you know. We obviously have to work it out in a way that is satisfactory to the Department of Defense because it perhaps impacts them as much, if not more, than us.

AIR INTERDICTION INCREASE

I would like to say for the record that our budget for air interdiction is increased, as you know, by some $16 million, and it was the major item which my predecessor appealed to OMB in the budget process as far as the Treasury Department's budget is concerned.

So we certainly believe in strengthening our interdiction efforts in every way we can.

Senator DECONCINI. Yes; I am aware of that, Mr. Secretary, and I compliment you and your predecessor for doing that and winning with OMB. The Secretary of Defense has indicated support for the amendment and it is in the House language. I hope to offer it today on our bill.

In this increase that you have added—$16 million—has there been any consideration for funds or planning for that air wing, or would that require additional consideration and funding?

Secretary BAKER. Well, we have not determined the amount of additional funding required from the Treasury Department. It would obviously require the commitment of resources from the Department of Defense.

The increase which we are seeking, and to which OMB has agreed, would be applied entirely for the operation and acquisition of originally planned aircraft. It would not have been budgeted for the new air wing.

Senator DECONCINI. Yes; my concern is if that air wing comes about in 1986, do you have any plans regarding personnel? As you are probably aware, that air wing would be available to customs people when not being used by military reserve trainees.

Are there any plans in the 1986 budget if that comes about?

Secretary BAKER. No, sir; there are no plans in the 1986 budget, and the increase in air interdiction dollars that we have asked for are committed to other areas.

Senator DECONCINI. Based on what is coming?

Secretary BAKER. That is right.

Senator DECONCINI. Fine; thank you, Mr. Secretary.

INTERNATIONAL AFFAIRS PROGRAM

Just a minor point, Mr. Secretary. You are requesting nearly $13 million for your International Affairs Program, which is the same as last year. And even though you are holding the line on spending for international affairs, could we not cut the international affairs activities substantially next year?

Your Treasury agencies are being cut back sharply in many other areas. What would happen if a 10-percent cut were made in that particular line item?

Secretary BAKER. I would think that would be a very, very unfortunate circumstance, Senator. The Treasury Department plays a central role in the formulation and execution of our international economy policy.

In that regard, the Secretary of the Treasury, as you know, is governor of the four multilateral development banks and the principal economic adviser to the President. We have economic summit obligations which we have to discharge. We have meetings of the multilateral lending institutions throughout the world.

Senator DECONCINI. This would be detrimental to you?

Secretary BAKER. It would be, I think, extremely detrimental, and I have to say that I think the Treasury Department's record in this regard is a good one. If you take a close look, I do not think you would see junketing going on or any abuse of travel.

I think that those funds are well used and efficiently used, and I would strongly urge that you not seek to reduce that element of the Department's budget.

Senator DECONCINI. Well, you make a good argument, Mr. Secretary.

GRAY MARKETING IMPORTS

Mr. Secretary, Senator Abdnor and I have just recently written to your deputy, Mr. Darman, regarding the issue of gray marketing imports. We have been urging Treasury for nearly 2 years to come out with a new rulemaking.

The chairman and I have suggested in our letter that Treasury give serious consideration to the compromise known as demarking. Demarking would shift customs and the court's emphasis to one where so-called

gray market products could be admitted to the United States so long as the trademark was removed or covered up in some way.

This proposal would, at least, eliminate any restraint of trade concerns as well as any concerns about price maintenance. It also would smoke out the major issue of gray marketing in the trademark area.

Demarking would eliminate any ability of the gray marketers to take a free ride on the legitimate trademark of someone else.

Could you give us some assurance that you will issue new rules regarding gray marketing and consider demarking?

Secretary BAKER. Senator, I can give you assurance that we are going to examine the issue and, in fact, we are examining it now. We have a Cabinet-level working group that is reviewing the entire gray market goods issue, and it will be presenting recommendations to the President within a reasonable period of time.

I might add that there are vast differences of opinion on this not only within the executive branch, but within the legislative branch as well. We have received letters, for instance, on one side of the issue from Senators Rudman, Boren, Bentsen, Chafee, Chiles, Hawkins, Symms, and Roth, and on the other side from the chairman, yourself, Senator D'Amato, Senator Hatch, Senator Laxalt, and Senator Moynihan.

So I think we need to work the policy out and we are in the process of trying to do that.

Senator DECONCINI. That is part of the reason, I think, the chairman and I brought this to your attention—and maybe you already knew it. I am sure you did, but we thought maybe a compromise of demarking might work. I do not know how it would sit with the other members that you cite there.

Though it does not go as far as I would like to see it go at least, it may be a compromise.

Secretary BAKER. That is one of the compromise positions that is being examined by the Cabinet-level working group.

Senator DECONCINI. Thank you.

Mr. Chairman, I have a lot of other questions, but I do not want to hold up Senator Mattingly here. He has been very patient and was here first.

Senator ABDNOR. Senator Mattingly?

MONEY LAUNDERING

Senator MATTINGLY. Let me just add something I hope we all continue to talk about in reference to drugs and the illegal drug traffic that we have got here. In reference to the laundering of money, in light of the Boston controversy, evidently there are a lot of other banks that have been reporting, I guess, to you all in reference to their negligence in reporting these large transactions.

Are you stepping up a lot of the enforcement in that respect and policing of those cash transactions? What success are you having?

Secretary BAKER. The answer to that, Senator, is we are stepping it up and there are additional investigations ongoing. And the banks that you

mentioned in your question, I think, came forward in the aftermath of the Bank of Boston circumstance to, in effect, disclose what their self-policing examinations have revealed.

All I can say beyond what I have just said is it is a very active area and we are very actively involved in it.

Senator MATTINGLY. I also serve on the Banking Committee. Does your Department need any additional legislative authority?

Secretary BAKER. I think we have the basic authority that we need, Senator. However, the Department of Justice, and we, are looking at the issue and may develop a proposal that will increase certain penalties in this area.

Senator MATTINGLY. I think in the past we have been talking about——

Secretary BAKER. By the way, may I just interject, if I might?

Senator MATTINGLY. Yes.

Secretary BAKER. Going back to Senator DeConcini's question about the International Affairs Office of the Treasury Department, that office, as well as the Enforcement Office, is involved in this area as well as tax policy.

We continually have problems with offshore governments that we have to negotiate and work with in order to assist the Enforcement Office's activities in the money laundering area.

Senator MATTINGLY. Is that where the utilization of that money would be, the Bank of Nova Scotia, the Bank of the Bahamas?

Secretary BAKER. It is just another example of some of the demands that are put on that office.

CASINOS AS FINANCIAL INSTITUTIONS

Senator MATTINGLY. How about in respect to the gambling casinos? There has been some concern there in reference to them. There ought to be a lot of concern to them, but do you think they ought to be designated as financial institutions? Do you think we ought to change their designation?

Secretary BAKER. Senator, just a minute; let me make sure this is public.

Senator MATTINGLY. OK.

[Pause.]

Secretary BAKER. Senator, it is my understanding that we have proposed regulations which would designate casinos as financial institutions. I was also going to say that there is a major case in New York State involving laundering through casinos which I believe now is public, with some significant indictments having been returned by a New York Federal grand jury.

Senator MATTINGLY. Because they were doing pretty much a lot of the same transactions that banks are doing, but yet they were not classified that way?

Secretary BAKER. That is correct.

Senator MATTINGLY. I know that you all were considering the issue in the regulations, but you have not done it yet, right?

Secretary BAKER. We have not done it. It is my understanding that we are still considering those regulations.

Senator MATTINGLY. Now, do you need any additional legislative authority to do that, or do you want to just continue in the regulation area?

Secretary BAKER. On that particular issue, I do not think we need additional legislative authority.

Senator DECONCINI. Would the Senator yield for a followup question?

Senator MATTINGLY. Yes.

Senator DECONCINI. That is a subject that I have some interest in, and I know the Senator from Georgia has been very instrumental in that.

Mr. Secretary, can you tell us, are those regulations imminent? Are they going to come in the foreseeable future or is there still debate about it?

Secretary BAKER. I cannot answer that this morning, Senator, but I will be delighted to get an answer and give it to you for the record.

Senator DECONCINI. OK.

Secretary BAKER. I will have to talk to the Assistant Secretary for Enforcement. I do not know exactly where we are on those regulations.

Senator DECONCINI. Just from one Senator's point of view, I think that has been an overlooked area for a long time in organized crime—laundering money—and I want to urge the Treasury to do something about it.

Thank you.

Senator MATTINGLY. The problem there, is the drug smugglers are faster than the Government; they moved their money around.

Secretary BAKER. You asked me if any additional legislation was necessary and I said I did not think so at this time. I think that statement would apply as well to the regulations designating casinos as financial institutions.

I would like to say that we are considering establishing an office of financial investigations in the Office of the Secretary of the Treasury, it would not require legislation.

Senator MATTINGLY. As I say, I know that you all are very in tight with the DEA and everybody else in trying to pursue this. But as you know, it is a real war going on.

EQUALIZATION OF TRADE CONTRACTS

In reference to trade, I assume that you are on board with what we did in the Senate Budget Committee the other day in reference to using—you have got this $13 or $14 million for international work here, using the CCC commodities to try to create some equalization in some of the trade contracts that we have got out there in agriculture.

Now, are you all in sync with that?

Secretary BAKER. Senator, I am chairman of the Economic Policy Council, which is the coordinating body that considers domestic and international economic matters. We are in the process of working on that question and the guidelines for the operation of that program. We will be considering those issues at a meeting of that body within the next 2 weeks.

Senator MATTINGLY. Let me just sort of reinforce that. You know, nothing we have done in the last couple of years has been really—whatever has been accomplished has been very modest in the reduction of unfair barriers and subsidies that have been erected around the world.

It would seem that by just looking at the press lately, at least we got the attention of Argentina and Canada and the EC. We have finally done something that makes them fear what we maybe doing, so maybe that will give you all some impetus for them to reduce those barriers. I hope that we do not back off from this transaction that we are putting in there.

Secretary BAKER. It is my understanding that it was a matter that was agreed to by the administration in the overall budget compromise voted in the Senate.

Senator MATTINGLY. Yes; right.

Secretary BAKER. And it is a question now of establishing the guidelines. Of course, there is some flexibility, I suppose, in the way those guidelines are drawn in terms of the operation of the program.

Senator MATTINGLY. I would just like to say that everybody is waiting patiently, just like when E.F. Hutton speaks, for your new tax reform policy that is going to be coming out in about a week.

Thank you, Mr. Chairman.

Secretary BAKER. One week.

Senator MATTINGLY. One week; countdown time. [Laughter.]

Senator ABDNOR. Do you want to tell us anything about it? [Laughter.]

Senator DECONCINI. I was going to ask you about that, Mr. Secretary.

Secretary BAKER. No longer a hope; 1 week, unless we change our minds.

Senator MATTINGLY. That is all the questions I have.

Senator ABDNOR. Thank you.

IRS COMPUTER PROBLEMS

Let me jump back to IRS for a moment. There have been a lot of stories in the media with regard to the problems that the Internal Revenue Service has had with the new computer system and it has caused serious concern throughout the Nation.

Would you mind telling us a little bit about it as you see the problem with the IRS? I guess they initially faced a lot of problems. It is a whole new system, I am told. Could you just tell us a little about it and how we are doing today? What is the status?

Secretary BAKER. Well, all I can tell you is what I am told by the Commissioner, Mr. Chairman. But I am assured by him that the problems were largely the result of converting to a new computer system. It is his view that the problems will not reoccur.

As you may know, the House Appropriations Committee has provided an additional $33 million for IRS in its markup of the supplemental, and we think that is necessary and will be adequate to handle the problem. We do not anticipate that it is going to recur. IRS is, of course, operating on the assumption that the additional funds will be approved.

Senator ABDNOR. Is there a time period there that is very important in net dollars? That is on the supplemental?

Secretary BAKER. Time is important; we need the funds in the supplemental, yes, Senator, and we hope that the supplemental moves quickly.

Senator ABDNOR. Well, I visited with the Commissioner, too, and I guess it was a whole new field. Even the people who make the computers were a little lost on some of the bugs that they were finding. But it does look like they are clearing them up better now; I mean, they have them under control, I guess.

It does not take much to bring the public down on IRS anyway; they are not everybody's most popular agency in the country.

Secretary BAKER. That is right.

Senator ABDNOR. But it is a job that has to be done.

Senator Proxmire has joined us.

Senator PROXMIRE. Thank you, Mr. Chairman. Mr. Chairman, first I want to congratulate you on holding a meeting here in this room. This is the closest I have been to a Cabinet officer in about 5 years. [Laughter.]

It is a pleasant experience, especially with the Secretary of the Treasury. He is a wonderful man. He and I are fellow alumni of a fine school in Pennsylvania, the Hill School. He is the most prominent alumnus, of course; I am way down the list.

Mr. Secretary, the people of Wisconsin have been carrying on kind of a campaign to reduce the deficit and they have been letting me know by saying that they want to get their 2 cents' worth in and they have been sending me lots of pennies here.

This money may be peanuts in Washington, but they have shelled out their hard-earned money, and would you use it to reduce our debt?

Secretary BAKER. Would we?

Senator PROXMIRE. I hope you will. It is an unrestricted gift.

Secretary BAKER. You bet your life, Senator. We have a fund for this and I am delighted to have it. [Laughter.]

Senator PROXMIRE. Very good, and none of them will reduce their taxes by a charitable contribution in this case either. [Laughter.]

ECONOMIC GROWTH

Now, according to this morning's report, real GNP for the first quarter of the year was revised down from a sluggish 1.3 percent to seven-tenths, less than 1 percent. That is a pitiful figure. It is all the more frightening because real final sales grew only one-tenth of 1 percent and most of the growth occurred in business inventories.

In addition, the GNP price deflator increased 5.6 percent in the first quarter, compared with only 2.8 percent in the fourth quarter of last year. So we had inflation, on the one hand, increasing and we had growth slowing down.

The Consumer Price Index just released for April shows an increase of four-tenths of 1 percent, or an annual rate nearing 5 percent. Does that mean, in your judgment, that the economy is moving into a growth recession?

Secretary BAKER. No, sir; it does not. It means that the first quarter was a good bit slower than we anticipated. It means, in my view, that we are going to see a less strong second quarter than we originally anticipated.

But it does not mean that we will not be able to achieve our overall growth targets for the year. I think it is our view that the economy will strengthen considerably, particularly in the third and fourth quarters.

Senator PROXMIRE. Well, the overall growth target for the year, as I understand it, at least—this was what was set forth before—was 4 percent.

Secretary BAKER. That is correct, sir.

Senator PROXMIRE. Which is pretty ambitious when you have less than 1 percent in the first quarter and, as you say, it will be slower than we hoped it would be in the second. That means you are going to have to have a real boom in the third and fourth.

Secretary BAKER. Well, it means that the third and fourth will have to be quite strong, and we will be looking, Senator, at the estimates during the course of our midsession review in the latter part of next month.

IMPACT OF GROWTH ON REDUCING THE DEFICIT

Senator PROXMIRE. Now, if you are in error and the growth is, say, 3 percent in the third and fourth quarters, which would mean overall growth for the year closer to 2 percent, what does that slowdown mean in terms of reducing the deficit? Would that not mean a $20 or $30 billion less reduction?

Secretary BAKER. I cannot say that 3 percent would mean $20 or $30 billion, Senator. It would certainly mean less growth which, in turn, would mean a larger deficit.

INTERNATIONAL TRADE DEFICIT

Senator PROXMIRE. What has been the contribution of the international trade deficit to the Federal fiscal deficit?

Secretary BAKER. Well, I am not sure I understand your question. The current accounts deficit or the merchandise trade deficit——

Senator PROXMIRE. The merchandise trade deficit, the fact that we had $123 billion last year; this year, it will be, what, $140 billion or so in deficit?

Secretary BAKER. Yes, sir.

Senator PROXMIRE. Which means, of course, that we are buying more from abroad, selling less abroad. The jobs have been exported to some extent. We have lost some people, say, 2 million jobs, and my question is what effect has this had on the fiscal deficit.

Secretary BAKER. Well, I cannot quantify that for you, Senator. I simply do not know. I cannot say that it has not had some effect because I think it perhaps has, but I do not have a specific figure this morning.

DESTRUCTION OF TAX RETURNS

Senator PROXMIRE. Mr. Secretary, have you taken any steps to investigate the charges that the Internal Revenue Service has destroyed some tax returns, or looked into this situation regarding tax returns being delayed?

Secretary BAKER. Yes; I have, Senator. I have asked IRS to give me a report on it, and I have a preliminary report which would indicate that there might have been some correspondence destroyed. I am not aware of any tax returns having been destroyed.

There have been, or will be, certain personnel actions taken with respect to those matters.

Senator PROXMIRE. But there have been no tax returns destroyed? I read a report that in the Philadelphia office, there had been some destruction of tax returns, but that is incorrect?

Secretary BAKER. Well, I interpreted your question meaning has there been any willful destruction of tax returns. I am not aware of any, no, sir. Now, whether there have been some that might have been——

Senator PROXMIRE. Inadvertently?

Secretary BAKER. Inadvertently destoyed by a machine or something; I cannot answer that.

REGULATION OF SECURITY MARKETS

Senator PROXMIRE. Recently, a number of securities dealers, selling mainly Treasury bonds, have gone bankrupt. Have those bankruptcies hindered Treasury's ability to finance our debt, and do you see any need for regulation of these markets?

Secretary BAKER. The answer to the first question is no, they have not hindered our ability to finance the debt at all. And the answer to the second question is we, along with the Federal Reserve and SEC, are actively looking into the question of whether or not the Government securities dealers should somehow be regulated.

It is my understanding that we will have a recommendation for the Congress about June 21, when Chairman Shad is due back up to testify.

Senator PROXMIRE. Probably the Banking Committee.

Secretary BAKER. Yes, sir; we have not reached a conclusion as yet. We are actively working on that problem.

Senator PROXMIRE. Now, your office——

Secretary BAKER. It is my understanding, Senator, 25 to 27 of the biggest Government securities dealers are on a regular reporting basis now to the Federal Reserve System. And there have not as yet, as I understand it, been problems with any of those dealers.

The SEC, as you know, has security fraud authority, with respect to any securities, including Government securities. So it is a question of how much more, if anything, ought to be done.

OFFICE OF THE SECRETARY—FISCAL YEAR 1986 REQUEST

Senator PROXMIRE. Now, your Office of the Secretary budget for next year is down about $2.2 million below last year's level of $78.9 million, but still up sharply over 1984 levels.

Your budget in fiscal year 1984 was about $67.2 million, or about 14.2 percent less than your 1986 request. What would be the effect on your ability to manage the Treasury Department if the committee were to cut your Office of the Secretary budget back to $72 million next year?

That would give you about a 7-percent increase over your 1984 level, and could you be as specific as possible about what you could not do with this lower budget?

Secretary BAKER. Let me let the Assistant Secretary for Administration take that question, if I might, Senator.

Mr. ROGERS. Senator Proxmire, I think that would have a negative effect on our ability to operate Treasury. I think if you look at levels over the last 3 years——

Senator PROXMIRE. Let me just interrupt. When you say a negative effect, does that mean that the result would be that there would be a net loss for the Federal Government because you would not be able to operate as efficiently?

Mr. ROGERS. I believe you could probably show that, sir, in terms of the positions that might have to be reduced further. I think if you look at the changes that are proposed for 1986, we are already taking a substantial reduction—including a 10-percent administrative cut; and the 5-percent reduction in salaries.

We are talking about relatively stable funding levels between fiscal year 1980 all the way through to the proposed budget for fiscal year 1986.

Senator PROXMIRE. Now, your Office of the Secretary budget includes——

Senator ABDNOR. We are going to run out of time before too long and I want to give Senator DeConcini——

Senator DECONCINI. Go ahead and finish your question.

Senator ABDNOR. Is this the last one? Go ahead if it is.

Senator PROXMIRE. I will just ask this one and then I will be through.

CONSULTING SERVICES—OS

Your Office of the Secretary budget includes $1,192,000 for consulting and related services, about the same as last year. With a staff of over 1,120 positions, including over 400 program professionals, why do you need to spend nearly $1.2 million next year for consultant services?

Secretary BAKER. Senator, there are certain particular tasks for which we might not have the expertise in-house. There are technical studies that we do from time to time primarily to facilitate the tax and economic policy work.

I took a little tour of the Tax Policy Office this last week just because those people have been working overtime on tax reform and I found that there were a number of consultants there working on the Tax Reform Program. It is that kind of thing that that $1 million represents.

Senator PROXMIRE. You have such excellent personnel. I am surprised you do not have the capability in the Department itself without going outside.

Secretary BAKER. They are absolutely first-class. I would say with respect to tax reform this is the first time that we have attempted an overhaul of this magnitude of the Tax Code all in one bite and there are things that we have needed consultants for.

Senator PROXMIRE. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you.

Senator DeConcini?

Senator DECONCINI. Thank you, Mr. Chairman.

MORTGAGE-BACKED HOMEOWNER BONDS

Mr. Secretary, I sent you a letter on March 14 of this year requesting background material on the revenue assumptions that Treasury has made in the area of installment sales treatment of mortgage-backed homeowner bonds.

This morning, I finally received an answer after hammering away on some of your people over there. However, the letter states that the homebuilding industry has been unwilling to provide us, meaning you, the Treasury, with details underlying their estimates of the impact of this proposal.

The letter goes on to indicate that, therefore, your office will not share the background for your revenue assumptions. My staff has spoken with a representative of the National Association of Homebuilders and their ad hoc coalition to preserve homeowner bonds.

They assure me that they are more than willing to share information and I hope, therefore, that you will see that Mr. Pearlman makes available the ability for these two parties to get together.

Secretary BAKER. Absolutely, Senator. I was not aware that we said we could not share the information.

Senator DECONCINI. Yes; I was disappointed because I would like to see it myself. Obviously, I have the same interest of the homebuilders,

but they have denied me the information. I doubt if it is classified or anything, and I would appreciate it if we could see it.

But I also think it is proper that your people be entitled to the information from the homebuilders and they are willing to do it.

Secretary BAKER. We will get you the information, Senator.

Senator DECONCINI. Thank you.

Now, Mr. Secretary, we have raised this issue in the last couple of years on homeowner bonds or builder bonds, and the homeowner bonds are bonds sold by the public as a means of raising construction capital.

As you know, the interest earned on these bonds by their holders is taxable. The collateral used to back these bonds comes from home mortgages. Under present provisions of the Tax Code, the funds raised through builder bonds are not considered taxable. However, the funds generated from the home mortgages serving as collateral are considered taxable income.

TAX TREATMENT OF HOMEOWNER BONDS

This tax treatment allows the builder to obtain the maximum level of usable installment capital through long recognized installment sales. The tax package presented earlier this year by Treasury recommends a change in the tax treatment of homeowner bonds.

If this were to be accomplished, has Treasury come up with an alternative financing, or can you tell us in your proposal that comes out next week, or do I have to wait until next week to find out what you are going to do to homeowners bonds?

Secretary BAKER. I have been resisting, Senator, entreaties to, in effect, prejudge the President's decision by saying what will or will not be in the tax reform package, and I should continue to observe that.

But let me say a couple of things about what you call homeowner bonds and we call builder bonds.

Senator DECONCINI. Builder bonds is fine; I am comfortable with that, too.

Secretary BAKER. I think that there are a couple of points that I would like to make in the event that it stays in Treasury II; it was in Treasury I, as you know. The proposal is not limited to builders. It would apply to any amount borrowed which is secured by an installment obligation.

If the change were enacted into law, it would not impede access to the capital markets by builders. I mean, they would still have, I think, the same access to the capital markets that they have with their ability to treat the thing as an installment obligation.

Senator DECONCINI. But do you think you would continue to let them treat it as an installment obligation?

Secretary BAKER. What I was saying is even if we took the position that they should not be treated as an installment obligation, since they have received all the cash for it——

Senator DECONCINI. Right.

Secretary BAKER. No. 1, it is not discriminatory against builders. It applies to anybody who is, in effect, pledging——

Senator DECONCINI. Excuse me. You would apply it to everyone; not just homebuilder bonds?

Secretary BAKER. Across the board, yes, sir; that is correct, yes, sir.

Senator DECONCINI. That is your intent?

Secretary BAKER. Well, I am saying if it survives——

Senator DECONCINI. If it survives, yes.

Secretary BAKER. If it stayed in the package, it would be applied across the board and would not limit access to the capital markets by builders.

Senator DECONCINI. Well, Mr. Secretary, this really troubles me. I talked with your predecessor at great length about the history of these builder bonds which came out of a period of time when it was almost impossible for homebuilders to raise capital.

The interest rates were 17 percent and they, through their own innovativeness, came up with a pretty neat project that I think maybe we in Government kind of forced upon them in order to continue to supply reasonable cost mortgages.

Now that they have done it, and it is doing well, interest rates are down now, hopefully, forever or for a while. But I hate to see us pick on some group that has responded to an economic radical adjustment that they had to come to. I realize it is revenue, but I just wanted to leave that with you.

TREASURY'S TAX PROPOSAL

Let me go to your tax proposal, and I realize that you are not prepared to make any announcements here. The discussions have been, at least in the paper, about the great concern of adjusting the rates upward, I guess, in order to secure the revenues.

As you know, the Simpson-DeConcini proposal, or Hall-Robuska proposal, calls for a flat 19 percent. No major congressional proposal for tax reform calls for higher than 30 percent.

I wonder what your worry is of a low rate. Why can we not just go to first-year expensing out of these capital investments? I am afraid your answer is going to be because it is going to be short in revenue producing.

But, you know, is this not worth a creative risk when you are really making a radical change in the system? Based on some of the studies and information that the Hoover Institute has put together, I wonder if you just have disregarded it—when I say that, I am wondering if you have come to the conclusion that it is not sound or the risk is too great.

Secretary BAKER. No, sir; we have looked at it very carefully, as you and I have discussed and as indeed we have discussed with the authors of that plan. It is not so much that we are unwilling to take a creative risk, out in the fiscal circumstances that we find ourselves, if indeed going to that low a rate would create revenue problems for us, which it

does on a static basis, that is a risk we really do not think we should take, particularly at this time.

There is another problem we have with it, though, Senator, and that is the distributional effect. What it would do is, in terms of the effective tax rate, give people at the upper end of the tax scale a much bigger tax decrease in terms of effective rate than people in the middle income or lower income levels. For that reason, it would tend to be regressive, and we think would not garner the support that is necessary to give it a chance of passage up here in the Congress.

Senator DECONCINI. Do you disagree with Hall and Robuska, Mr. Secretary, that 80 percent would pay a lower tax rate—80 percent of the taxpayers?

Secretary BAKER. Everybody would pay a lower tax rate, but the burden would be distributed in a way that people at the upper end would pay a much lower rate than people in the middle or at the lower end.

Senator DECONCINI. Those who are paying the rate now.

Secretary BAKER. And it would not be distributionally neutral in that regard. It would tend to be regressive, and we think that would affect its chances for passage.

PROPOSED TAX REFORM DEDUCTIONS

Senator DECONCINI. And yet, from what I hear you are going to do, you are constantly reconsidering and adjusting what deductions you are going to leave in. One of the beauties of the Hall-Robuska proposal is that it takes them all out and you expense capital outlays the year they are made, with only carryover. I presume that is just not worth it.

Secretary BAKER. No, sir; in my view, there are strong economic arguments that can be made for that plan, and I suppose the major problem is one of a revenue shortfall overall and a lack of distributional neutrality. It is not distributionally neutral.

Senator DECONCINI. Let me go to the last question, then I will submit the balance of them, Mr. Chairman, on this subject matter.

If you are committed and convinced that you have to have a progressive tax structure, what is the argument that is prohibiting you on full expensing of capital outlays the year they are made, with carryover until they are used?

It seems to me that it makes so much sense and would be such an incentive for real economic growth, at least that part of it, even if you feel that you have to have a progressive——

Secretary BAKER. It would be, I think, an incentive. Again, it would create major revenue problems and it would continue to permit many companies to, in effect, zero out.

Senator DECONCINI. Well, when you are talking about revenue problems, you are talking in the first years or so.

Secretary BAKER. Yes, sir.

Senator DECONCINI. But that gets to my question. Is not the risk great enough for that economic growth? Hall and Robuska, it seems to me, make a very convincing argument in their proposal of how that will create tremendous economic growth, which is part of the importance of your whole provision.

Secretary BAKER. We think that that argument is sound, and we think that, quite frankly, the President's proposal will create additional economic growth. It is not something, though, that we can measure in precise terms.

Senator DECONCINI. I understand.

Secretary BAKER. And so we are judging our proposal on a basis that does not include growth, although we believe and expect that there will be additional growth.

Senator DECONCINI. What concerns me, Mr. Secretary, is as you focus in on this thing—and maybe it is too simplistic to go to the Hall-Robuska expensing plan—you constantly expand what you feel is necessary, whether it is the oil industry or it is the real estate tax credit or something else.

And then how do you explain to somebody who cannot get in under the cover? I think that is the problem you are going to face as you continue to expand which, as it appears from news articles, is what you are doing.

Secretary BAKER. Let me say this, if I might, Senator. The President's proposal, when it is announced, will be a substantial reform proposal. It will not simply be a proposal to cut individual rates.

There will be some popularity, I hope, for the proposal insofar as it does reduce rates further. But there will be substantial reform elements. They will not be as substantial as they were in the original package, but, after all, if we are going to get reform, we have to start with something that we can pass.

Senator DECONCINI. Yes; I understand. Will it be revenue-neutral, or can you tell us that?

Secretary BAKER. Yes; it will be revenue-neutral, and it will be, to the extent possible, distributionally neutral, and it will be, to the extent possible, economically neutral.

Senator DECONCINI. Mr. Chairman, thank you. I want to thank the Secretary for exchanging his views here with us as candidly as he did, and I have a number of questions I will submit.

Senator ABDNOR. We are getting right near the deadline. Senator Proxmire?

Senator PROXMIRE. Let me just make a point that the last two quarters of real GNP growth would have to average about 6.1 percent to meet the 4-percent target, assuming the second quarter increases to 3 percent. So it looks as if it is going to be a tough order to do that.

Now, let me ask you one question which is kind of along the line of my golden fleeces, but I am sure you can handle it. It is not big with $200 billion deficits, but you are requesting $105,000 for official reception and representation expenses next year.

REPRESENTATION EXPENSES

Last year, your combined representation allowance for the Office of the Secretary in international affairs was about $93,000. Even the President's expense allowance is only $50,000. The entire Customs Service allowance is only $15,000. The U.S. Trade Representative has an allowance of $72,000.

Why do you need over $100,000 for official reception and representation next year, and what would be the effect on your ability to conduct Treasury policy if we were to cut that back to $50,000?

Secretary BAKER. I think it would be very detrimental, Senator, and I think it is misleading to suggest that the President's allowance is only $50,000. That is a $50,000 personal allowance that is given to him to spend for that purpose and there are other significantly greater allowances for Presidential spending of that nature.

Let me say, I think I said before you came in here, that the Treasury plays a central role in the formulation and execution of our international economic policy. We have calling upon us finance ministers representing most of the leading nations of the world, and it is an absolute, I think, disgrace the way we are funded to treat those people and the way we have to handle that representation, particularly when you compare it to the standards that I think are quite appropriate that are followed over at the Department of State.

After all, we are talking about representing the United States, and we are talking about representing them on serious and substantive international economic matters. We have had to do a number of things that I think hopefully have improved the process a little bit.

The increase we are asking for is $10,000. I do not apologize for that one bit, Senator. I would be delighted to take you on a personal tour of our quarters and the rather dingy conference room that we meet in with these foreign finance ministers and dignitaries.

And I frankly think, particularly when you compare it with the way that they treat representatives of the United States, it is disgraceful.

Senator PROXMIRE. Well, my time is up, Mr. Chairman, but I do feel very strongly that this is the kind of symbolic expenditure which, in a time of austerity, we should try to reduce as much as possible.

Senator ABDNOR. Thank you, Senator Proxmire. The Secretary's time has expired, too, I guess. He has another meeting.

Secretary BAKER. May I add one thing?

Senator ABDNOR. Yes.

Secretary BAKER. Senator Mattingly asked me about the regulations designating casinos as financial institutions and I think I said we were looking at those regulations. They have been issued and they became effective on May 7, and I just wanted to get that in the record.

Senator ABDNOR. Fine.

FEDERAL LAW ENFORCEMENT TRAINING CENTER

One last question from me that you can quickly answer. Talking about the Federal Law Enforcement Training Center—you are part of it—I guess I was just wondering about your feelings.

I would ask you to take a look at the possibility of a unified budget for training at this center. Have you heard any discussion of that? I suppose it comes under your job, but we just think it might be a better operation as a unified budget.

Secretary BAKER. What do you mean by that, Mr. Chairman?

Senator ABDNOR. Well, I guess when this was originally set up, it was to train our law enforcement people. I think we would put it all under the Treasury if I had a unified budget concept here instead of charging off to this group and that group.

We have been talking about the Capitol Police, paying for the basic training there. I do not think that was the purpose of getting this started. I mean, it is the central area for our training for law enforcement in the Federal Government.

And it has been a very successful program, but I think if it were under the Treasury, it would be easier to keep track of how we operate. It goes to several, does it not?

Mr. ROGERS. Yes; we are forced to do some of the training on a reimbursable basis, switching away from central budgeting.

Senator ABDNOR. Yes.

Mr. ROGERS. And we are aware of your interest, and Chuck has been down there, and we are happy to take a look at that.

ADDITIONAL COMMITTEE QUESTIONS

Senator ABDNOR. Well, very good. We are going to have other questions for the record that we will submit to you in writing, if you do not mind.

[The following questions were not asked at the hearing, but were submitted to the Agency for response subsequent to the hearing:]

ADDITIONAL COMMITTEE QUESTIONS

BATF REGULATIONS FOR BEER AND WINE ADVERTISEMENT

Question. There has been a good deal of controversy over the question of alcoholic beverage advertising on television. The BATF has jurisdiction over such advertising and has developed some proposed revision to the advertising regulations. I believe that ATF has to act and act soon. What is the status of the advertising revisions?

Answer. The draft notice of proposed rulemaking to which you are referring is presently under review in Treasury. The notice raises questions concerning the appearance of celebrities (rock stars, athletes) and the use of athletic events in alcohol advertising. The notice indicates that the Federal Alcohol Administration Act prohibits statements in advertisements which are false, misleading, deceptive, disparaging, obscene, or indecent, or that make curative or therapeutic claims. Although the act does not specifically address many modern day health and safety concerns, Treasury recognizes these concerns and is striving in the regulatory proposal to develop a responsible policy within the limits of its mandate.

IRS Computer Problems

Question. The reports in the media with regard to the problems the Internal Revenue Service has had with its new computer system have caused serious concern throughout the Nation. Could you briefly outline the problems the IRS initially faced? The status as of today? Whether all of the bugs have been worked out? And what amount the Treasury expects to pay in interest penalty.

Has there been an estimate of the revenues lost to the Government because returns with payments were not processed in a timely fashion?

Answer. In order to understand the 1985 filing season, it is important to understand the magnitude of the equipment conversion effort that was undertaken this year by the Service and the limited options available to them. In addition to the conversion of a number of operations to new equipment, the conversion effort involved changing computer languages from assembly language to cobol and rewriting 1,500 programs, comprising 3.5 million lines of code. Perhaps the most important lesson learned from this year's filing season is that despite careful planning and scale-model testing, you cannot know how a high-volume data processing system will work until you actually place the high volume on the system. When IRS put the 1985 filing season volume on the system, they experienced additional problems in the hardware, the software, and the operation of the system. As the problems arose, they were identified and resolved. Some problems were to be expected from the conversion, and IRS actually experienced somewhat more problems than anticipated. But there simply was no alternative to the replacement of the aging equipment.

The following table best illustrates the situation this year with regard to interest paid on refunds on timely filed returns:

INTEREST PAID ON TIMELY FILED INDIVIDUAL INCOME TAX RETURNS

Week ending	Total returns	Total refunds	Interest
1984:			
Jan. 24—May 30	65,382,000	$53,012,322,000	
June 6	220,000	256,194,000	$3,746,000
June 13	217,000	197,011	3,109,000
Total	65,819,000	53,465,527,000	6,855,000
1985			
Jan. 24—May 30	65,946,000	54,396,649,000	
June 6	228,000	155,093,000	2,433,000
June 13	299,000	206,495,000	3,552,000
Total	66,473,000	54,758,237,000	5,985,000

We are encouraged by the fact that the processing effort for these first two cycles has cut roughly in half the IRS' June 1 inventory of approximately 1 million refund returns yet to be processed. In 1984, IRS had well over 1 million refund returns yet to be processed at this time.

These figures represent interest paid for only a 2-week period. IRS estimates that processing of timely filed 1984 returns will be virtually completed by the end of July. While the data so far is promising, it is only preliminary. We will not know the full story until the data becomes available later this year.

There was no revenue lost to the Government on returns with payments attached. IRS' processing procedures provide for detaching payments from the returns and depositing them to Treasury accounts in the Federal Reserve or other authorized depositary banks within 24 hours of receipt.

Question. The IRS budget proposes that 7,500 people be hired during the next 3 fiscal years for new tax initiatives. Could you outline what those initiatives could be and what does the Department hope to accomplish?

Answer. In his report to the President, Peter Grace and his commission noted that examination staffing had not kept pace with tax return filings, and thereby recommended an increase of 7,500 average positions to the Examination Program over a 3-year period.

In response, the administration has proposed a revenue initiative that would add 7,500 average positions to the Examination Program in 1987, 1988, and 1989–2,500 average positions in each fiscal year. Over this 3-year period, the additional staff would generate actual revenue collections of $4.6 billion at a cost of $624 million. This represents a return of $7.40 for every $1 spent. Over a 7-year period, this enforcement staff would generate $5.7 billion in actual revenue collections at a total cost of $665 million, a net return of 8.6 to 1.

These yield and cost estimates are based on 2,500 new average positions being available on October 1 of each fiscal year. IRS will begin advance hiring late in fiscal year 1986 to ensure full revenue potential in fiscal year 1987. Before then, the fiscal year 1987 budget, containing the revenue initiative proposal, will have been presented to the committee. This will give the committee another opportunity to discuss the merits of the proposal.

Questions Submitted by Senator Dennis DeConcini

Appropriations Committee Directives

Question. Secretary Baker, one of my concerns, as ranking member on this subcommittee, has been that some of the Treasury agencies are ignoring committee directives and recommendations in the report that accompanies your appropriation bill every year. For example, Customs refused to fill four slots in Milwaukee, WI. They failed to comply with a committee directive setting up a drug task force in Hawaii, including 25 customs staff. And despite a good-faith effort by INS to beef up staff in Nogales, AZ, customs did not comply with an identical directive to assign more people to the border in Nogales.

As the new Secretary, what will be the Department's position regarding compliance with report language in fiscal 1986? Or do we have to write all of our directives into the appropriations bill itself to get things accomplished?

Answer. It is our intention to comply wherever possible with the subcommittee's report language, and we do not believe that the Congress should include such directives in the appropriations bill itself. In the instances cited, however, I am told that under existing overall staffing constraints, such factors as workload and drug threat do not justify the changes included in the committee's report. Thus, while we intend to comply with the committee's directives wherever possible, there are occasions where different action may be warranted. For example, on occasion the House and Senate reports accompanying the respective appropriations bills may be in conflict. Another example would be where the committee has directed actions that, upon further review and study, are not justifiable in light of the overall mission and workload of a bureau. Where we do not believe it to be feasible to comply with a particular directive, it is our intention to inform the committee and discuss the matter with you.

Merger of Coast Guard and Treasury

Question. Mr. Secretary, I understand that the administration is giving serious consideration to putting all drug interdiction agencies under one roof. Specifically, I am told that one option getting top considerationis to put the Coast Guard back into the Treasury Department. Frankly, this is something that makes sense if we are going to consolidate our top two drug interdiction agencies in one shop.

What is the status of these discussions—are they serious or just another bureaucratic dream that keeps showing up in memos in Treasury or the Department of Transportation? What would be your view on putting Coast Guard into Treasury?

Answer. This is a matter that has been discussed recently, and in our judgment further review is warranted. However, the Treasury Department does not have any active proposal to move the Coast Guard out of the Department of Transportation.

Minimum Corporate Tax

Question. In this morning's Washington Post, Majority Leader Robert Dole seemed to indicate that a minimum corporate tax was a live possibility as a bargaining chip with the House budget conferees. Obviously, any tax increase would have to be achieved either through reconciliation or through introduction of a freestanding tax bill.

The President continues to sound firm in his oposition to any tax increase.

What will be the disposition of the administration if a minimum corporate tax makes it through Congress and lands on the President's desk later this summer?

Answer. The administration would oppose any tax increase, whether through an increase in individual or corporate tax rates or, absent a fundamental tax reform measure that reduces corporate tax rates, through a new corporate minimum tax. The administration supports the concept of a strengthened corporate minimum tax only in the context of significant rate reduction through fundamental reform.

Tax Simplification

Question. Mr. Secretary, your predecessor took the courageous, politically difficult step of proposing a tax simplification plan for the President. It received mixed reviews up here and mixed reviews in the business sector.

Now you are on board. The President has said, "no tax increases." You have repeated that position publicly. But now I would like to get an update from you on what the Baker tax simplifcation plan looks like at this point: what changes have been made in the Regan tax simplifcation plan; and any other information you can tell us about the administration's tax simplifcation initiative.

Answer. There will be significant changes in the plan originally propsed by former Secretary Regan. These changes will be fully detailed in the proposals when submitted to Congress.

Child Care Credit

Question. I understand you are considering changing the child care tax credit to a deduction. This could have a disastrous effect on the welfare of children in America. It is extremely shortsighted to economize on the future of America's children. The child care problem in America is one of great proportions; replacing the child care credit with a deduction will worsen the problem. Let me cite a few statistics:

(1) Almost two-thirds of all mothers of school-aged children are in the labor force;

(2) Half of all mothers with preschool children now work outside the home;

(3) By 1984 almost 80 percent of American women between the ages of 25 and 54 will be working;

(4) In 1983, both parents were working in about 60 percent of American households;

(5) 6.5 million latch-key children lack adult supervision before or after school; and

(6) The number of single fathers raising children has doubled since 1970 to 1.5 million solo fathers raising 3.5 million children.

What these statistics add up to, Mr. Secretary, is a serious crisis in child care. If you eliminate the tax incentive to have adult supervision of children, you may eliminate the ability of many American families to afford child care.

In light of these facts, what justification can you find for changing the child care tax credit?

Answer. The administration's proposal to change the child care credit to a deduction recognizes that child and dependent care expenses constitute legitimate costs of earning income which affect a taxpayer's ability to pay taxes. A family with $30,000 of income and $2,000 of employment related child care expenses does not have greater ability to pay tax than one with $28,000 of income and no such expenses. Although child care expenses reduce the ability to pay tax at all income levels, the current credit for child and dependent care expenses is targeted for the benefit of low-income taxpayers. The administration's proposal thus provides tax relief for all taxpayers who incur child care costs. Under the administration's proposals, additional tax relief is provided for low-income taxpayers through lower tax rates, larger exemptions, and larger zero bracket amounts.

TAX PROPOSAL

Question. Mr. Secretary, it has been rumored that your tax proposal will make major changes in present provisions on employer-paid health insurance. Under present law, they are not taxed. In former Secretary Regan's proposal they were taxed for amounts over $70 for an individual and I understand that your proposal will tax amounts below $10 for an individual. Perhaps the aim of this proposal has not been clear to me, but it seems we are not getting at any possible problems of abuse of employer-paid health insurance, but rather are penalizing the little guy. Isn't this correct?

Answer. Under current law all employer contributions to health insurance plans on behalf of an employee are excluded from the employee's gross income. The same rule generally applies to amounts paid by an employer to or on behalf of an employee under a self-insured medical plan. However, although medical expense reimbursements under a self-insured plan must be provided on a nondiscriminatory basis to be excludable, similar benefits provided through an outside insurer are not subject to nondiscrimination rules.

The administration's tax reform plan would require that employer contributions to a health plan be included in the employee's gross income up to $10 per month ($120 per year) for individual coverage of an employee, or $25 per month ($300 per year) for family coverage. In addition, nondiscrimination rules would be applied to employer-provided health benefits, regardless of whether employer health plans are self-insured or provided through third parties.

As explained in more detail below, we believe that these proposals would make the tax system fairer, especially with respect to low- and middle-income employees.

The purpose of including $10 per month (or $25 for family coverage) in an employee's income is basically twofold. First, including this amount in income reduces the inequity between an individual receiving health benefits from his or her employer and an individual who is not covered by an employer health plan. While the former essentially obtains health services with pretax dollars, the latter must pay for the same services with after-tax dollars. Under the proposal, a portion of the employer-provided health benefits would be subject to tax, so that with respect to this portion the two individuals described above would be treated the same.

The second purpose of including the $10 per month (or $25 for family coverage) in income is to help broaden the base of taxable income and thus reduce marginal rates without jeopardizing the national policy of encouraging essential health care services.

The administration's proposal will be simple to administer, since almost all employees with employer contributions will have such contributions in excess of the proposed includable amounts. Only in those rare cases where the employer's contribution is expected to be less than $10 per month (or $25 for family coverage) per employee, will estimates and confirmations of the actual cost be necessary.

The tax on the $10 per month (or $25 for family coverage) will be paid primarily by higher income taxpayers, in part because such taxpayers are in a higher bracket and thus will pay more tax on the same amount of income. In fact, families with incomes above $30,000 would pay three-quarters of the taxes imposed on employee contributions. Less than 5 percent of the additional tax liability would fall on those with under $15,000 of income, and, due to the increased personal exemption and zero bracket amounts, generally no taxes would be paid by families with incomes below the poverty line.

As noted, the administration tax reform proposal would also subject all employer-provided health insurance plans to a nondiscrimination rule. The purpose of this rule is to deny the exclusion for employer-provided health benefits where the benefits are provided primarily for the high-income employees. The health benefits exclusion exists largely to ensure adequate health care protection for low- and middle-income employees. The proposed nondiscrimination rule is an important step in ensuring that protection.

RECOGNITION OF GAIN ON PLEDGES OF INSTALLMENT OBLIGATIONS

Question. Finally, one more question on homeowner bonds. It is unclear from the Treasury proposal if you intend to pursue only homebuilders using the installment sales treatment or if this is intended to extend to other industries in which installment obligations are used as collateral for borrowing.

Answer. Under the Treasury proposal, the pledge of an installment obligation as security for a loan would cause recognition of all or a portion of the gain remaining to be recognized by the taxpayer with respect to the installment obligation. The amount of gain recognized would depend primarily upon the amount of the borrowing and whether it was incurred in the ordinary course of business. Exceptions would be provided for short-term borrowings and certain indebtedness owed to a financial institution and secured by a general lien on all of the borrower's trade or business assets. The general lien exception would not apply to a case, such as a single-purpose financing subsidiary, where substantially all the borrower's assets are installment obligations.

By its terms, the Treasury proposal would apply to the pledge of any installment obligation as security for a loan, unless one of the specific exceptions is applicable. In recent years, not only homebuilders, but also builders of commercial real estate and manufacturers of large equipment have issued bonds and debentures secured by their installment receivables. The Treasury proposal would somewhat reduce the tax benefits of such transactions. In addition, individual taxpayers have used installment obligations as security for indebtedness incurred for personal expenses. The Treasury proposal would eliminate the tax benefits of such transactions.

CONCLUSION OF HEARINGS

Senator ABDNOR. I want to thank you, Mr. Secretary. We have been looking forward to having you. We had to cancel before because of some big issue on the floor I was vitally interested in.

It is great to have you back, John, and we are going to look forward to working with you. We have always had a fine relationship.

I just want to tell the—well, I am the only subcommittee member here, I guess, but I think Chairman Hatfield is tentatively scheduling a markup on this 1985 supplemental for June 6, and so I will be getting back to the members. We will do it in writing, I guess.

But this takes care, I think, of all our hearings for the year, and if there is no further business to come before the subcommittee, we will stand in recess until the call of the Chair.

[Whereupon, at 11:17 a.m., Tuesday, May 21, the hearings were concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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